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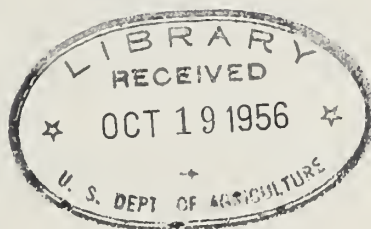


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Report Of The  
FEDERAL MILK ORDER STUDY COMMITTEE  
on its review of the  
Federal Milk Marketing Order Program



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FEDERAL MILK ORDER STUDY COMMITTEE

October 7, 1954

Honorable Ezra Taft Benson  
Secretary of Agriculture  
U. S. Department of Agriculture  
Washington 25, D. C.

Dear Mr. Secretary:

There is attached copy of the report of the Technical Committee established by you on May 27, 1953, to study and review the Federal Milk Marketing Order Program.

While the report is quite extensive, the field was broad and many of the problems which the Committee thought should be studied have not been included, primarily because of time.

It should be understood that, while the report is submitted as a Committee report, individual members may not subscribe to every phase of the report.

The members of the Committee are - -

W. H. Alexander, Louisiana State University, Baton Rouge, Louisiana  
E. W. Gaumnitz, National Cheese Institute, Inc., Chicago, Illinois  
L. S. Holler, Belle Vernon Company, Cleveland, Ohio  
James H. Larson, Dairy Cooperative Institute, Shawano, Wisconsin  
Gordon C. Laughlin, Consolidated Dairy Products Company, Seattle, Washington  
Frank Lent, Dairywomen's League Coop Association, Inc., New York, New York  
George K. Lufty, 7401 Melrose Street, Detroit 11, Michigan  
A. L. McWilliams, Pure Milk Association, Chicago, Illinois  
E. M. Norton, National Milk Producers Federation, Washington, D. C.  
Otie M. Reed, National Creameries Association, Washington, D. C.  
C. W. Swonger, New England Milk Producers' Association, Boston, Mass.  
E. E. Vial, Milk Dealers' Assn. of Metropolitan New York, New York  
Earl Warner, Ohio Wesleyan University, Delaware, Ohio  
W. N. Waterstreet, The Borden Company, Chicago, Illinois  
Wm. C. Welden, H. P. Hood & Sons, Inc., Boston 29, Massachusetts

Respectfully Submitted,

Chairman

E. W. Gaumnitz

General Statement  
Report of Technical Committee Established by the Secretary  
of Agriculture, U. S. Department of Agriculture, May 27, 1953,  
to Study and Review the Federal Milk Marketing Order Program.

This is the report of the Technical Committee established by the Secretary of Agriculture on May 27, 1953, to review the Federal Milk Marketing Order Program.

The Committee apparently was the outgrowth of recommendations made by a larger industry group of some one hundred people called together on April 2 and 3, 1953, in Washington for the purpose of outlining suggestions relative to an overall dairy program. For the most part that industry group was concerned with dairy price support programs for the year 1953-1954, as well as with the development of a longer term dairy program. That group divided into the following six sub-groups: Production; Distribution of Fluid Milk; Manufactured Dairy Products; Wholesaling and Distribution of Dairy Products; Retail Stores and Restaurants; and Research, Education and Promotion. The subgroups on Production, Distribution of Fluid Milk, Manufactured Dairy Products and Retail Stores and Restaurants recommended that operations under Federal Milk Orders be reviewed, presumably with the objective of suggesting changes which would increase the consumption of milk and dairy products. It was also suggested that such a review be undertaken by a special committee.

At the end of that conference it was recommended that a smaller task group be assembled to review and consolidate the recommendations of the 100-man group. The smaller task group met on May 11 and 12, 1953 and made a series of recommendations. At the first meeting of the Federal Milk Order Committee on June 10, 1953, the Administrator of the Production and Marketing Administration, U. S. Department of Agriculture, in outlining the origin and purposes of the Committee reported that one of the resolutions of the Task Group in its meeting on May 11 and 12 was as follows:

"Whereas, various comments indicate that (a) the use in the present form of so-called economic factors for pricing Class I milk; (b) the soundness of the relation between milk for bottling, for cream and manufacturing milk; (c) the restrictions within the orders on movements of milk between markets and participation in markets; (d) the present method of pricing manufacturing or surplus milk; and (e) other terms and provisions of the Federal Milk Marketing orders indicate the desirability of a review of the program."



The Administrator in outlining further the scope and terms of reference of the Committee stated the following:

"This is a broad assignment, and the areas of study will be determined by your Committee. Your recommendations may suggest, among other things, proposed improvements in the Marketing Agreement Act itself, changes in the Administrative Procedures Act, changes in the procedures for formulating and issuing orders or changes in specific milk orders. In this connection it is pointed out that under existing legislation any action taken by the Secretary must be based on evidence submitted at a public hearing with respect to a specific order. We request that you present a written statement to the Department covering your studies with specific recommendations covering each point you would like us to consider. It is to be understood that your recommendations are for the specific use of the Department and that the work of this group is not subject to review or approval of either of the earlier appointed dairy committees."

At its first meeting the Committee outlined four general areas of study:

- (1) Purposes of orders.
- (2) Pricing policies including an examination of prices established for milk under orders and criteria and techniques of pricing.
- (3) Provisions relating to or affecting the movement of milk and milk products in order markets.
- (4) Administration of the Order Program.

Subcommittees were established to assemble material with reference to those subjects and to prepare preliminary reports for consideration by the full Committee. Probably no useful purpose is served by detailing the problems outlined for study by each of the subcommittees or the procedures which were followed. Needless to say, the problems to be considered were extensive and the job of assembling basic data was extremely broad. The several subcommittees secured a major part of their information from U. S. Department of Agriculture sources in response to specific requests.

The Committee was not in a position to analyze in detail all of the problems which were originally outlined. Rather the Committee attempted to review what it considered the principal problems on a broad level. Of necessity, individual market problems were considered only as such problems were illustrative of general problems.

There were several meetings of members of individual subcommittees. In addition, there were five meetings of the full committee. For the most part, the meetings of the full committee ran for two to three days.

This report is divided into the following parts:

- I. Pricing Policies
- II. Movement of Milk and Milk Products into Markets
- III. Administration

Pricing Policies -- In Part I, data are presented designed primarily to determine whether Class I prices are reasonable. From the data presented in the section on pricing and from its consideration of the objectives of Federal Milk Marketing Orders, the Committee has drawn the following conclusions:

1. The primary purpose of Federal milk marketing orders is to maintain an adequate supply of milk, and to achieve orderly marketing. This is being accomplished in fluid milk markets with Federal orders.
2. During the post-war years the margin of Class I prices over manufacturing prices has been wider on a dollars and cents basis than in former years. This has been true in all types of fluid milk markets including Federally regulated, State regulated and non-regulated markets.
3. This situation resulted primarily from the wartime shortages and the need to obtain additional supplies for many fluid markets. The Committee has developed no adequate explanation for the continuance of the wide margins between prices of fluid milk relative to manufacturing milk prices in recent years.
4. In recent years these shortages have been generally eliminated, and have been replaced in many instances by over supply in relation to fluid needs.
5. Formula pricing and particularly supply-demand price adjustments have served to reduce Class I prices as supplies became more ample, but have not, in most markets, narrowed the spread between fluid milk prices and manufacturing milk prices.
6. Lags occur in adjustments of production and consumption to price changes.
7. There is little evidence that Federal orders have increased production more than has occurred in other markets or areas of the country. Due to shifting of plants and producers, the receipts of milk at plants subject to a Federal order do not necessarily reflect changes in area production. In the Northeast, which is the only area for which fairly comprehensive figures are available, total milk production in relation to Class I utilization has not been as high as it was in the early forties.



8. Two general types of Class I formulas are now in use: One is the type which uses manufacturing milk prices as the mover and the other uses various indices of economic factors. Each has advantages depending on local market conditions. Whichever is used, it is essential to have an adequate supply-demand adjustment. The ultimate test of the soundness of any pricing program for fluid milk is the maintenance of an adequate supply in relation to the fluid market requirements.

Movement of Milk and Milk Products into Markets -- In Part II of the report, two statements are included relating to the movement of milk and milk products into markets. This is in recognition of the fact that this subject is one of the most controversial. Each of the two reports represents a complete statement on the subject -- each is complete in itself. One statement sets forth the analysis supporting the inclusion of the present order provisions regarding compensatory payments and plant classification; the other sets forth the analysis against such provisions in Federal orders. The Committee was unable to compose the differences. Ten members of the Committee indicated their belief that compensatory payments were a necessary part of market-pool orders, and three members indicated they did not believe that such provisions were necessary or should be included in market-pool Federal orders.

Despite the disagreement among the members of the Committee on the necessity for the use of compensatory payment and assignment of classification provisions, the Committee is in substantial agreement on certain general comments that may be made regarding such provisions. These comments are all interrelated but may be broken down to facilitate their consideration. These comments are:

- "1. No evidence was developed to indicate that the use of compensatory payments and plant classification provisions has been abused up to this time. However, the data before the Committee with reference to available supplies of milk necessarily related to so-called pool milk, rather than milk which was received from nonpool plants, or which was available, but not shipped to the market, and was therefore not ascertainable.
- "2. Some means is essential to identify the participants in a market pool, or define the scope of regulation.
- "3. It is conceivable that compensatory payments and plant classification provisions might be so used to limit the supply of milk fully priced and pooled in a market that the volume of such milk would not serve as a reliable indicator for sound pricing. Under such conditions so-called automatic supply-demand adjustment provisions would become less effective. This problem is primarily one of sound administration, in the public interest.
- "4. The appropriate relation between the supply-demand adjustment provisions, and the compensatory payment and plant classification provisions will vary according to local market conditions.
- "5. Care should continue to be exercised in designing such provisions in each individual market order so that compensatory payments and plant classification provisions do not obscure, or render ineffective, the supply-demand adjustment provisions."



Administration -- In Part III, specific recommendations regarding Administration are set forth.

General -- For more than twenty years the facilities of the Federal Government have been available to producers of milk who, for one reason or another, have found it necessary to request the use of Congressional authority for fixing minimum producer prices for fluid milk in their local market.

From the very beginning of Federal milk regulation, it was determined that no regulation would be issued without the request and approval of producers. Subsequently, Congress provided that a milk order shall not become effective unless approved by two-thirds (or three-fourths, according to the type of pool) of the producers in the market; and that the regulation shall be terminated at the request of 50 percent of the producers.

Each milk order has been developed around the peculiar facts in that market. The provisions of an order take into consideration the local problems which are found in every fluid market.

The development, acceptance, and support of this program are founded upon the unusually high standards of public service by the qualified personnel responsible for the promulgation and administration of the milk orders. The program will continue to hold its position only so long as it is able to attract and hold this personnel with unusual qualifications.

In reviewing the criticism of this program, it appears that much of it originates from producers and handlers who failed to secure a specific provision in the marketing order and from dairy farmers and plant operators not directly subject to orders who believe themselves affected by the orders. Without a review of the hearing record in each such case it is impossible to determine whether there is any reasonable basis for such complaints. Congress has provided an adequate remedy in this regard. Of course, any decision involving the terms of a milk order requires consideration of complicated economic factors which must be weighed with the "public interest," as required by Congress.

Many of the milk orders have been reviewed by the Judicial Officer of the Department of Agriculture, under the statutory proceedings for administrative review. The opinions of the Judicial Officer have charted a course which serves as a continuing guide to the Department and the fluid milk industry in the administration and enforcement of the program. It is significant that the rulings of the Judicial Officer have been modified by the courts in only a few cases.

The classification, auditing, and pooling phases of the program have given a stability to the large markets which has resulted in orderly marketing which could not have been maintained in the absence of these orders. The auditing procedure has made a substantial contribution to the accepted integrity of the program.

The pricing mechanism provided by these regulations has been quite successful in minimizing dealer-farmer controversies in times of peace and war, and through periods of high and low production. It has adapted itself successfully to a wide variety of economic conditions. The present period of high production is a further test of the ability of this type of regulation to meet changing economic situations in the industry. If proper recognition is given to price adjustments in relation to supply and demand, there is every reason to believe that Federal Orders will continue to serve the useful purpose which has characterized their operation for the past fifteen years.

An appraisal of the program would not be complete without reference to the public acceptance of the method established by Congress for fixing the prices to producers. The public forum, presided over by a representative of the Government, with a complete transcript of all the testimony of producers, handlers, and consumers continues to provide bases for decisions which have eliminated much of the suspicion and misunderstanding regarding the fluid milk business.

I Section On  
Pricing Policies

REPORT OF FEDERAL MILK ORDER STUDY COMMITTEE

Agriculture - Washington

October 1954



## FEDERAL ORDER STUDY COMMITTEE

## Pricing Policies

This section of the report dealing with pricing policies is devoted primarily to a study of

1. The Class I price formula in Federal Orders.
2. Relationship of Class I prices to prices paid for milk for manufacture.
3. Appraisal of Class I prices:
  - (a) Class I prices in Federal Order markets compared to other types of markets.
  - (b) Class I prices compared to cost of supplementary or competing sources of supply.
  - (c) Shifts in market requirements in relation to supply.
4. Surplus pricing.
5. Summary

## CLASS I PRICE FORMULA-FEDERAL ORDERS

Every federal milk marketing order had a formula for establishing the Class I price as of June 1953. In no market was a fixed Class I price specified in the order which remained in effect until changed through the hearing and amendment procedure.

The Class I formula in effect can be classified into two general types, as follows:

1. A differential over the price of milk for manufacture; and
2. A base price adjusted by indexes of various economic factors.



## DIFFERENTIAL OVER MANUFACTURING VALUE

With this type of formula the Class I price is set at a specified dollars-and-cents differential over the value of milk for manufacture. The differential in practically all markets varies on a seasonal basis.

Of the various formulas of this type in effect in June 1953 there were several methods used to determine the value of milk for manufacture, as follows:

1. The price paid producers for milk at a specified group of manufacturing plants;
2. A computed value of milk for butter and powder; and
3. A computed value of milk for butter and cheese.

In a considerable number of markets the paying price at the "18 condenseries" was used. In other markets this series, together with some local manufacturing plant prices, was used. The computed values of milk for butter and powder and for butter and cheese were based on various market prices or quotations, specified yields or weights and a manufacturing allowance for making the particular products.

In most of the orders the Class I price differential over the value of milk for manufacture was a differential over the highest of two or more of the above measures of the value of milk for manufacture.

For example, in the Chicago market the measures of the value of milk for manufacture were (a) the 18 condensery price and (b) a butter-powder formula. The specified Class I differentials applied to the higher of the two basic formulas, and were as follows: May-June, \$0.60; July-November, \$1.10; and December-April, \$0.80. The average of the 12 monthly differentials was \$0.89.

There was considerable variation between markets in the 12-month average differential over the value of milk for manufacture, varying from a low of \$0.85 for Milwaukee to a high of \$2.50 for the Central-West Texas market. There were 8 markets with differentials of less than \$1.00, 21 with differentials of \$1.00 to \$1.49, and 10 with differentials of over \$1.50 (Table 1).

TABLE 1. NUMBER OF FEDERAL ORDER MARKETS WITH VARIOUS CLASS I PRICE DIFFERENTIALS OVER MANUFACTURING VALUE OF MILK

12-month average premium over manufacturing value  
(dollars per 100 pounds 3.5 milk)

Range <sup>1/</sup>	Average	Number of markets
\$0.80-0.89	\$ 0.87	3
0.90- 0.99	0.92	5
1.00- 1.09	1.03	2
1.10- 1.19	1.10	3
1.20- 1.29	1.24	8
1.30- 1.39	1.34	4
1.40- 1.49	1.44	4
1.50- 1.59	1.53	2
1.60- 1.69	1.65	2
1.70- 1.79	1.75	3
1.80- 1.89	1.85	1
* * * * *		
2.10- 2.19	2.15	1
* * * * *		
2.50- 2.69	2.50	1
Average or total	\$1.33	39

<sup>1/</sup> These differentials were also subject to adjustment by use of "supply-demand adjustment" formulae incorporated in the various orders.

TABLE 2. FEDERAL ORDER CLASS I PRICE DIFFERENTIALS OVER MANUFACTURING VALUE OF MILK - AVERAGES BY STATES

Area and State	Number of Markets	Average annual differential	Area and State	Number of Markets	Average annual differential
<u>East North Central</u>			<u>South</u>		
Wisconsin	1	\$0.85	West Virginia	1	\$1.34
Illinois	1	0.89	Kentucky	2	1.25
Indiana	2	1.16	Tennessee	3	1.41
Ohio	7	1.22	Arkansas	1	1.75
Michigan	1	1.43	Texas	2	2.32
<u>West North Central</u>			<u>Other</u>		
Minnesota	2	0.98	Washington	1	1.65
Iowa	4	0.94			
Missouri	4	1.20			
South Dakota	1	1.25			
Nebraska	1	1.40			
Kansas	2	1.50			
Oklahoma	3	1.78			
Total or average			18	39	\$1.33

On a geographic basis, the lowest differentials, less than a dollar, occurred in Wisconsin, Illinois, Iowa and Minnesota, while the high ones, \$1.75 or over, were in Arkansas, Oklahoma and Texas (Table 2). This type of formula, a differential over the manufacturing value, was used in 18 states.

#### BASE PRICE ADJUSTED BY ECONOMIC FACTORS

The economic factors used in adjusting the base period price varied from market to market. The various items used were as follows:

1. Wholesale price index all commodities.
2. Disposable income.
3. Department store sales.
4. Sales of non-durable goods.
5. Cost of dairy ration.
6. Farm wage rates.
7. Condensery price of milk.
8. Prices of all farm products.

This type of formula is in effect in 9 markets located in 5 states; namely, Massachusetts, New York, Pennsylvania, Louisiana and Texas.

It is crystal clear that in the general type of formula where the Class I price is set at a differential over the value of milk for manufacture, there is a definite policy of using the price of milk for manufacture as a mover for the Class I price. The actual change in the Class I price, with a given change in the manufacturing value, may be modified by the seasonal factors in the formula, and by the "supply-demand adjustment factor." On the other hand, in the type of formula where the base price is adjusted by economic factors, the movers in the Class I price are not directly related to the manufacturing value of milk. Thus, with this type of formula, the Class I price might increase, show no change, or decline, when the value of milk for manufacture declined, stood still, or increased.



## SUPPLY-DEMAND PROVISIONS IN CLASS I PRICING FORMULAS

As a means of avoiding the delays involved in amendment procedure, pricing formulas have been adopted in all of the orders. The major competitive influences which determine the necessary level of Class I prices are reflected by the formulas relating such prices to manufactured milk prices or to general economic conditions. The device of formula pricing has been of great benefit in keeping milk prices adjusted to changes in economic conditions affecting the dairy industry, but amendments are necessary from time to time to meet variations in supply-demand conditions in individual markets.

In recent years, many of the Class I pricing formulas have been amended to incorporate a "supply-demand adjustment." This device serves automatically to adjust Class I prices when supplies of milk get out of line with sales. It adds a further automatic adjustment to the pricing formula, as a means of maintaining a desirable relationship between market receipts and fluid milk (or milk and cream) requirements. It is an application of the principle of "flexible supports" related to supply-demand conditions in fluid milk markets.

Such a provision operates to reduce the Class I price when supplies are excessive, and to raise the Class I price when supplies are inadequate, in relation to market requirements. Automatic adjustments of this type are useful in several different types of situations. One is to correct disparities in prices which may arise between adjacent markets, and restore a balanced condition of supply. Another is to adjust prices in line with changes in production technique or consumption habits, affecting supply and demand for fluid milk. Another is to meet a situation in which the whole level of dairy product prices is too high or too low in relation to feed and other cost factors, or to other production alternatives.

This type of formula adjustment has been in widespread use in federal order markets for only a relatively short period of time. Since production adjustments in dairy farming are relatively slow, results are not to be expected overnight.

The effectiveness of supply-demand provisions has also been reduced by the appearance of general farm surpluses, and by acreage controls for so-called "basic" crops which have tended to seal off other alternative opportunities for employment of agricultural resources.

#### CLASS I VS. CONDENSERY PRICE

In the last 15 years there has been a striking change in the margins between Class I prices and prices paid for milk for manufacturing. In general, after World War II price controls were terminated the margin between Class I and prices paid by condenseries has averaged much greater than in earlier years. Much the same type of shift occurred in federally-regulated, state-regulated and non-regulated markets.

#### FEDERAL ORDER MARKETS

The Class I prices in a selected group of federal order markets and the prices paid by "18 midwest condenseries," together with the margin between the two price series, are shown for the period 1940-1953 in Table 3, while similar data for a group of state-regulated and non-regulated markets are presented in Table 4.

During the 7-year period 1940 to 1946 the New York Class I price varied from \$0.88 to \$1.26 more than the condensery price. In the following 7-year period 1947 to 1953, the range was from \$1.42 to \$2.40. The average margins for the two periods were \$1.02 and \$1.90, respectively. Each of the other selected federal order markets, where the data were available back to 1940, showed a noticeably wider margin between the Class I and condensery price since the end of World War II price controls than formerly (Table 3). These average margins for the selected markets for the two periods, in dollars per 100 pounds of milk, were as follows:

Market	1940-46	1947-53	Increase
Boston	\$ 0.94	\$ 1.85	\$ 0.91
New York	1.02	1.90	0.88
Chicago	0.65	0.83	0.18
New Orleans	0.67	2.03	1.36
Average (4)	0.82	1.65	0.83

The increases in the margins for New York and Boston were much the same. The increase for Chicago was by far the smallest, and for New Orleans by far the greatest, \$0.18 and \$1.36, respectively.

#### NON-FEDERAL MARKETS

The selected group of non-federal markets (Table 4) was further subdivided into state-regulated and non-regulated, non-regulated meaning that there was no price control by a public agency, federal or state. In each of these markets there was a marked increase in the Class I condensery price margin from the early forties to the late forties and early fifties.

In the group of state-regulated markets the smallest increase of the Class I price over the condensery price was for Los Angeles, and the largest for Portland, Oregon, \$0.68 and \$1.49, respectively. The average increase for the six markets was \$1.12. In some state-regulated markets the Class I price established by the control agency does not apply to all the Class I milk sold in the market because the state has little or no control over the price paid producers outside the state for milk shipped into the state.

For the three non-controlled markets the average increase in the Class I condensery price margin was much the same as for the six state-controlled markets, \$1.18 and \$1.12, respectively. The average Class I condensery price margins for the two 7-year periods 1940-46 and 1947-53 for the state-controlled and non-controlled markets, per hundred pounds of 3.5 milk, were as follows:

State-controlled	1940-46	1947-53	Increase
Providence	\$1.66	\$ 2.78	\$ 1.12
Rochester	1.28	2.35	1.07
Pittsburgh	1.06	2.04	0.98
Birmingham	1.37	2.74	1.37
Los Angeles	0.98	1.66	0.68
Portland, Oregon	0.63	2.12	1.49
Average (6)	1.16	2.28	1.12
Non-controlled			
Washington, D. C. <sup>1/</sup>	1.49	2.77	1.28
Des Moines	0.38	1.22	0.84
Denver	0.42	1.84	1.42
Average (3)	0.76	1.94	1.18

<sup>1/</sup> Federally-regulated for part of the time



TABLE 3. CLASS I PRICES SELECTED FEDERAL ORDER MARKETS AND PRICES PAID BY 18 MID-WESTERN CONDENSERIES <sup>1/</sup> - 1940-1953  
(dollars per cwt of 3.5 milk)

Year	Class I prices)							
	Boston	New York	Chicago	New Orleans	Cincinnati	Cleveland	Minneapolis-St. Paul	Condensery 2/
	\$	\$	\$	\$	\$	\$	\$	\$
1940	2.59	2.61	1.94	2.13				1.35
1941	2.67	2.73	2.37	2.32				1.85
1942	3.15	3.14	2.74	2.74				2.07
1943	3.50	3.53	3.32	3.29	3.27			2.62
1944	3.56	3.79	3.34	3.40	3.36			2.64
1945	3.56	3.70	3.30	3.38	3.52			2.60
1946	4.13	4.33	4.15	4.03	3.95		4.04	3.45
1947	4.92	4.91	4.16	4.54	4.68	4.50	4.16	3.49
1948	5.65	5.66	4.78	5.33	5.25	5.18	4.60	3.97
1949	5.30	5.26	3.77	5.13	4.34	4.14	3.79	2.86
1950	4.98	5.00	3.68	5.38	4.28	4.03	3.74	2.95
1951	5.43	5.64	4.39	5.68	5.08	4.81	4.30	3.62
1952	5.53	5.50	4.81	6.03	5.40	5.14	4.58	3.78
1953	5.03	5.23	4.16	6.00	4.90	4.87	4.18	3.24

Margin of Class I over Condensery (dollars per cwt.)

								Average margin	
								4 markets	7 mkts.
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Aver. 40-46	0.94	1.02	0.65	0.67				0.82	---
Aver. 47-53	1.85	1.90	0.83	2.03	1.43	1.25	0.78	1.65	1.44
1940	1.24	1.26	0.59	0.78				0.97	
1941	0.82	0.88	0.52	0.47				0.67	
1942	1.08	1.07	0.67	0.67				0.87	
1943	0.88	0.91	0.70	0.67	0.65			0.79	
1944	0.92	1.06	0.70	0.76	0.72			0.86	
1945	0.96	1.10	0.70	0.78	0.92			0.88	
1946	0.68	0.88	0.70	0.58	0.50		0.59	0.71	
1947	1.43	1.42	0.67	1.05	1.19	1.01	0.67	1.14	1.06
1948	1.68	1.69	0.81	1.36	1.28	1.21	0.63	1.38	1.24
1949	2.44	2.40	0.91	2.27	1.48	1.28	0.93	2.00	1.67
1950	2.03	2.05	0.73	2.43	1.33	1.08	0.79	1.81	1.49
1951	1.81	2.02	0.77	2.06	1.46	1.19	0.68	1.66	1.43
1952	1.75	1.72	1.03	2.25	1.62	1.36	0.80	1.69	1.50
1953	1.79	1.99	0.92	2.76	1.66	1.63	0.94	1.86	1.67

<sup>1/</sup> Data supplied by the Dairy Division, United States Department of Agriculture.

<sup>2/</sup> Originally 18 condenseries; in recent years a smaller number.

Table 4.- CLASS I PRICES SELECTED NON-FEDERAL MARKETS AND PRICES PAID BY 18 MIDWESTERN CONDENSERIES 1/, 1940-53

Year	Provi- dence, R.I.	Roches- ter, N. Y.	Wash- ington, D. C.	Pitts- burgh, Pa.	Ind. Ind.	Des Moines, Iowa	Denver, Colo.	(dollars per cwt. 3.5 milk)					Port- land, Ore.	Condensery Price 2/
								At- Jksn- ville, Fla.	Brug- lanta, Ga.	Hous- ton, Tex.	Los Ang., Cal.			
1940	\$3.42	\$2.81	\$3.24	\$2.66	\$2.17	\$2.00	\$2.02	\$3.25	\$	\$2.85	\$2.65	\$2.19	\$2.03	\$1.35
1941	3.58	3.25	3.37	2.92		2.10	2.09	3.37		2.92		2.57	2.33	1.85
1942	3.99	3.53	3.65	3.12		2.60	2.46	3.86		3.55	3.24	3.26	2.86	2.07
1943	4.09	3.80	3.90	3.66	3.29	3.00	2.90	4.62		4.01		3.66	3.18	2.62
1944	4.11	3.80	4.00	3.66	3.28	3.00	3.15	4.87		4.05	3.75	3.71	3.32	2.64
1945	4.11	3.80	4.02	3.66	3.28	3.00	3.15	4.88		4.05	3.72	3.72	3.32	2.60
1946	4.91	4.52	4.86	4.34		3.55	3.75			4.71		4.36	3.97	3.45
1947	5.69	5.37	5.74	5.12		4.39	4.66	6.39		5.85		4.80	4.86	3.49
1948	6.39	5.87	6.13	5.45		4.96	4.88	7.27		6.40	6.46	5.09	5.52	3.97
1949	6.26	5.70	5.97	5.35		4.62	4.94	6.99	5.77	6.01	6.48	4.82	5.34	2.86
1950	5.86	5.50	5.91	4.83	4.15	4.09	4.99	6.70	5.62	5.90	6.04	4.41	5.09	2.95
1951	6.38	5.93	6.33	5.51	5.03	4.67	5.46	6.85	6.36	6.24	6.87	5.06	5.98	3.62
1952	6.58	5.97	6.60	5.95	4.99	5.02	5.85	6.86	6.35	6.36	7.31	5.77	6.05	3.78
1953	6.18	6.00	6.60	5.99	4.55	4.73	6.02	7.16	6.38	6.30	6.71	5.55	5.89	3.24
AV.	40-46	1.66	1.28	1.49	1.06	0.38	0.42	\$	\$	\$1.37	\$	0.98	0.63	1.03
AV.	47-53	2.78	2.35	2.77	2.04	1.22	1.84	3.46		2.74		1.66	2.12	2.17
1940	2.07	1.46	1.89	1.31	0.82	0.65	0.67	1.90		1.50	1.30	0.84	0.68	1.23
1941	1.73	1.40	1.52	1.07		0.25	0.24	1.52		1.07		0.72	0.48	0.94
1942	1.92	1.46	1.58	1.05		0.53	0.39	1.79		1.48	1.17	1.19	0.79	1.15
1943	1.47	1.18	1.28	1.04	0.67	0.38	0.28	2.00		1.39		1.04	0.56	0.96
1944	1.47	1.16	1.36	1.02	0.64	0.36	0.51	2.23		1.41	1.11	1.07	0.68	1.00
1945	1.51	1.20	1.42	1.06	0.68	0.40	0.55	2.28		1.45	1.12	1.12	0.72	1.05
1946	1.46	1.07	1.41	0.89		0.10	0.30			1.26		0.91	0.52	0.88
1947	2.20	1.88	2.25	1.63		0.90	1.17	2.90		2.36		1.31	1.37	1.67
1948	2.42	1.90	2.16	1.48		0.99	0.91	3.30		2.43	2.49	1.12	1.55	1.66
1949	3.40	2.84	3.11	2.49		1.76	2.08	4.07	2.91	3.15	3.62	1.96	2.48	2.59
1950	2.91	2.55	2.96	1.88	1.20	1.14	2.04	3.75	2.67	2.95	3.09	1.46	2.14	2.23
1951	2.76	2.31	2.71	1.89	1.41	1.05	1.84	3.23	2.74	2.62	3.25	1.44	2.36	2.11
1952	2.80	2.19	2.82	2.17	1.21	1.24	2.07	3.08	2.57	2.58	3.53	1.99	2.27	2.24
1953	2.94	2.76	3.36	2.75	1.31	1.49	2.78	3.92	3.14	3.06	3.47	2.31	2.65	2.68

1/ Data supplied by the Dairy Division, United States Department of Agriculture.

2/ Originally 18 condenseries; in recent years a smaller number.

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# ALL MARKETS

The most comprehensive average of Class I prices on a nationwide basis is the average for about 125 markets, compiled by the Agricultural Marketing Service and published in the Fluid Milk and Cream Report. This series goes back to 1922. In compiling this average, no attempt is made to weight the prices for individual cities on the basis of the amount of milk involved. At the present time, there are about 50 federal order markets, and a decade ago there were probably not over half that number. Thus, it is clear that this all-market average of Class I prices is heavily weighted by non-federal markets. The national average of Class I prices and the average prices paid by all condenseries for selected periods, in dollars per hundred pounds of 3.5 milk, is as follows:

Period	Class I	Condensery	Margin
1922-29	\$ 2.68	\$ 2.00	\$ 0.68
1930-39	2.10	1.28	0.82
1940-46	3.00	2.36	0.64
1947-53	4.99	3.35	1.64
Increase 1940-46 to 1947-53			1.00

During the last 7 years the margin averaged \$1.00 more than in the early forties. It is interesting to note that the margin in the early forties and in the 1920's was approximately the same. In the depression years of the thirties it was relatively wide. The condensery price during this period averaged \$0.72 lower than the twenties, but the Class I price declined only \$0.58.

The changes in the Class I condensery price margin for the various groups of markets and all the markets, in dollars per hundred pounds of 3.5 milk, were as follows:

Type of market	1940-46	1947-53	<u>Increase</u>	
			Actual	Percent
4 federal	\$ 0.82	\$ 1.65	\$ 0.83	101
6 state-controlled	1.16	2.28	1.12	97
3 non-controlled	0.76	1.94	1.18	155
All markets (125)	0.64	1.64	1.00	156



In each group of markets the margin during the last 7 years has averaged about \$1.00 greater than in the preceding 7-year period. For the selected group of federal order markets the increase was somewhat less than a dollar, and for the selected group of state-controlled and non-controlled, somewhat more. The data are too meager to determine whether or not there was a significant difference in the increase in the margin between federal and other types of markets.

On a percentage basis the increase in the margin for the 4 federal and 6 state-controlled markets was much the same. In both cases the increase was about 100 percent. For the non-controlled markets and all markets combined, however, the increase was much greater - about 150 percent.

It is abundantly clear that margins between Class I prices and the prices paid producers for milk for manufacture have been much greater since the end of World War II than in earlier years. This widening spread has been practically universal regardless of the type of price control (Figure 1).

The rapid rise in Class I prices in relation to the condensery price got underway in 1947. OPA price controls were eliminated in the middle of 1946, and Class I prices and prices of milk for manufacture rose rapidly. Part of this rise compensated producers for the elimination of subsidies as of June 30, 1946.

In the various groups of markets the margin between the Class I and condensery price reached a peak in 1949. There was some decline in 1950 and 1951, but in 1952 and 1953 the general tendency was for the spread to widen again, and in many cases the 1953 margins were about the same as the peak in 1949 (Figure 1, Tables 3 and 4).

#### CLASS I PRICES PERCENT OF CONDENSERY

Over the years there have been marked changes in the general level of the Class I and condensery prices, and marked changes in the percentage relationship between them. During the twenties the all market Class I averaged about 35 per-  
cent higher than the condensery price. This was in striking contrast to 1932/1938  
when the premium over the condensery price was 93 and 81 percent. During the

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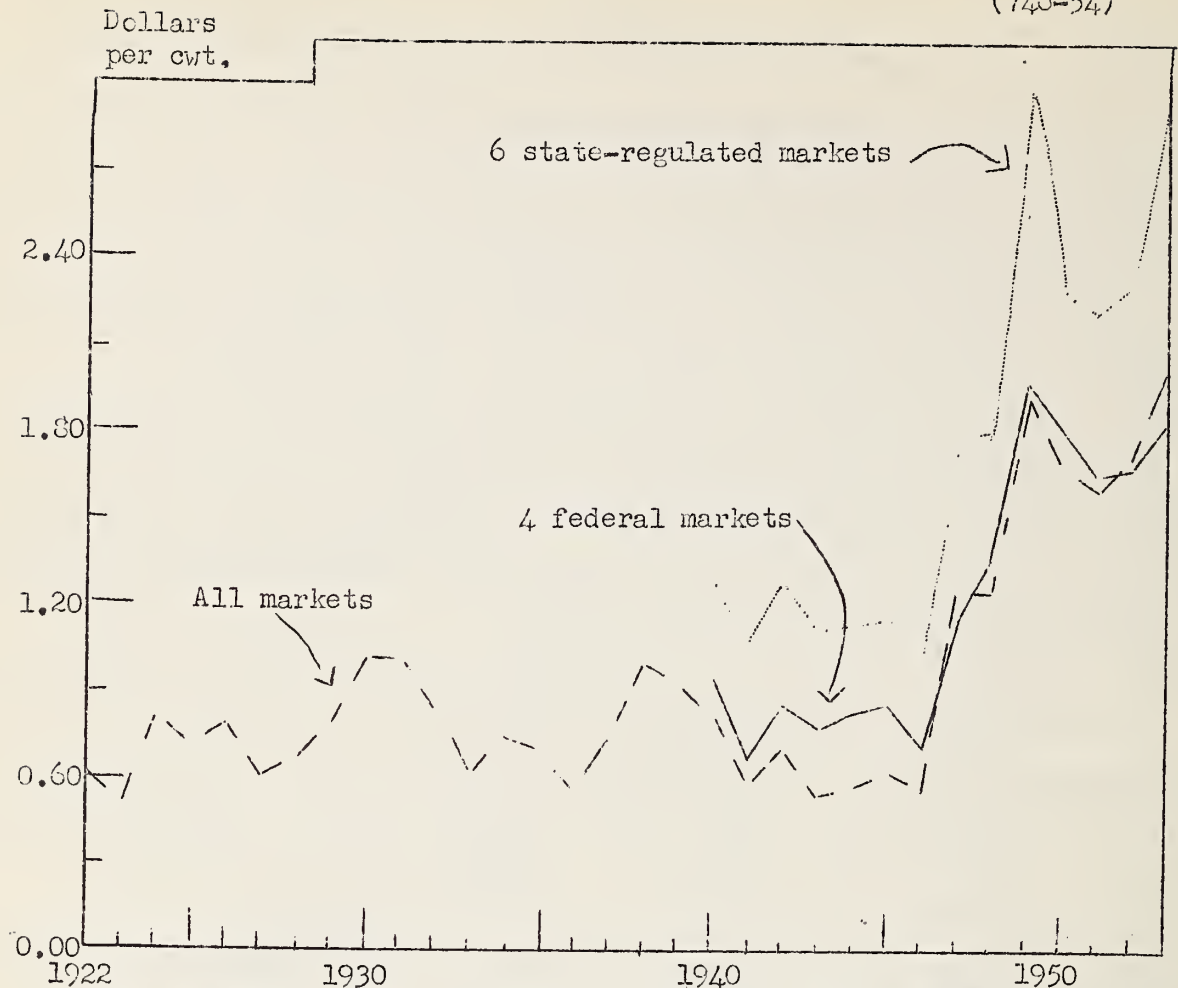


FIGURE 1. MARGIN BETWEEN CLASS I PRICE AND CONDENSERY PRICE OF MILK ALL MARKETS, 4 FEDERAL ORDER MARKETS AND 6 STATE-REGULATED MARKETS - 1922-1953.

From 1922 to 1946 the margin fluctuated from year to year but showed no consistent long-time trend to either increase or decrease. From 1946 to 1949 the margins increased phenomenally in each group of markets. There was some decline from 1949 to 1951, but in 1952 and 1953 the margins widened again. The margins for the selected group of state-regulated markets averaged higher than for the other group.

period from 1941 through 1948 the premium over the condensery price was much the same as in the twenties. In 1949, however, there was a sharp rise and the percentage premium nearly doubled. After a decline in 1950 and 1951 there was another increase in 1953 to about the 1949 level. During the last 5 years the Class I prices, expressed as a percentage of the condensery price, have averaged relatively high. The only periods when they were higher were in the early thirties and in the late thirties.

There was a great similarity in the general movement of the premium for the various groups of markets (Figure 2, Tables 5 and 6).



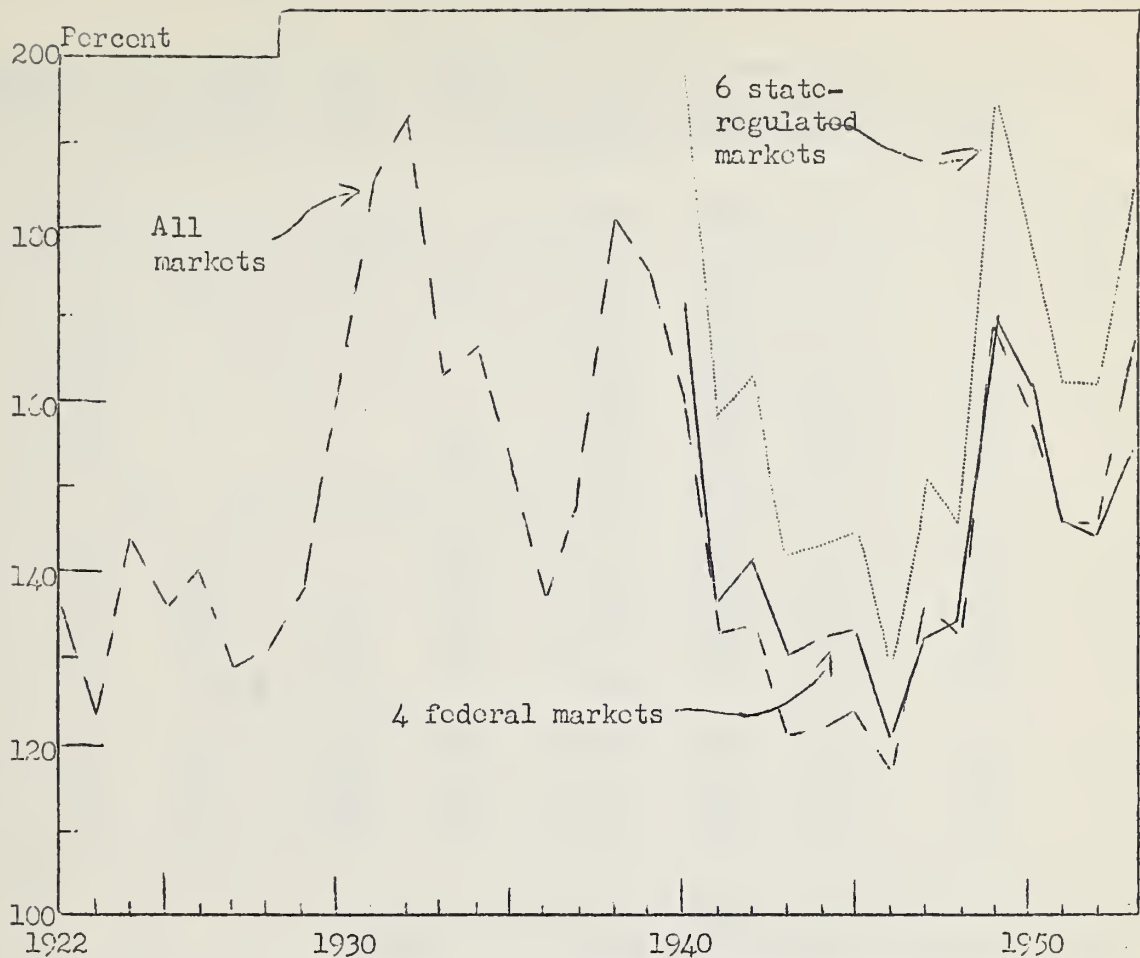


FIGURE 2. AVERAGE CLASS I PRICES FOR ALL MARKETS, 4 FEDERAL ORDER MARKETS AND 6 STATE-REGULATED MARKETS, EXPRESSED AS A PERCENTAGE OF THE CONDENSERY PRICE - 1922-1953.

On a percentage basis, Class I prices were high compared to the condensery price in the early thirties, the late thirties and in the fifties.

#### BLEND PRICE VS. CONDENSERY PRICE

Since the end of World War II price regulation, the uniform prices in the selected federal order markets have averaged higher, in relation to the condensery price, than in the early and mid-forties (Table 7). For example, during the period 1940-46 the Boston uniform price on a 3.5 basis ranged from \$0.35 to \$0.66 higher than the condensery price. During the following 7-year period the range was from \$0.96 to \$1.37 higher than the condensery price. The average differences for the two periods were \$0.54 and \$1.08, respectively.

TABLE 5. CLASS I PRICES SELECTED FEDERAL ORDER MARKETS EXPRESSED AS A PERCENTAGE OF THE CONDENSERY PRICE (18)<sup>1/</sup>  
(1940-1953)

Year	Boston	New York	Chicago	New Orleans	Cincinnati	Cleveland	Minn.-St. Paul	Average 4 mths. 7 mths.	
Aver. 1940-46 <sup>2/</sup>	140	143	127	128				135	
Aver. 1947-53 <sup>2/</sup>	154	156	124	159	142	137	123	148	142
1940	192	193	144	158				172	
1941	144	148	128	125				136	
1942	152	152	132	132				142	
1943	134	135	127	126	125			130	
1944	135	140	127	129	127			133	
1945	137	142	127	130	135			134	
1946	120	126	120	117	114		117	121	
1947	141	141	119	130	134	129	119	133	130
1948	142	143	120	134	132	130	116	135	131
1949	185	184	132	179	152	145	133	170	158
1950	169	169	125	182	145	137	127	161	151
1951	150	156	121	157	140	133	119	146	140
1952	146	146	127	160	143	136	121	145	140
1953	155	161	128	185	151	150	129	157	152

<sup>1/</sup> Calculated from data in Table .

<sup>2/</sup> Calculated from average prices for the two periods.

The average premiums of the uniform price over the condensery price for the two periods for a selected group of federal order markets, in dollars per 100 pounds of milk, were as follows:

Market	1940-46	1947-53	Increase
Boston	\$ 0.54	\$ 1.08	\$ 0.54
New York	0.61	1.03	0.42
Chicago	0.43	0.60	0.17
New Orleans	0.56	1.57	1.01
Cincinnati		1.08	
Cleveland		0.98	
Minneapolis-St. Paul		0.61	
Average (4)	0.53	1.07	0.54

For these federally-regulated markets it is clear that the margin of the blend price over the condensery price has averaged decidedly higher in the post-World War II period than in earlier years. For Boston and New York the increase was in the neighborhood of \$0.50 per hundredweight, for Chicago only \$0.17, but for New Orleans, approximately \$1.00.

TABLE 6 . CLASS I PRICES SELECTED NON-FEDERAL MARKETS EXPRESSED AS A PERCENTAGE OF PRICES PAID BY

CONDENSED SERIES (18) 1/ - 1940-1953

Year	R.I.	N.Y.	D.C.	Pa.	Ind.	Iowa	Colo.	Fla.	Ga.	Ala.	Tex.	Cal.	Ore.	Average
1/														
2/														
Ave. 2/	40-46	170	154	163	145	116	118	158	141	127	143			
Ave. 2/	47-53	181	169	181	160	136	154	201	180	162	163			
1940	253	200	240	197	161	148	150	241	211	196	191			
1941	194	176	182	158		114	113	182	158	139	126			
1942	193	171	176	151		126	119	186	171	157	138			
1943	156	145	149	140	126	115	111	176	153	140	121			
1944	156	144	152	139	124	114	119	184	153	142	126			
1945	158	146	155	141	126	115	121	188	156	143	128			
1946	142	131	141	126		103	109		137	126	115			
1947	163	154	164	147		126	134	183	168	138	139			
1948	161	148	154	137		125	123	183	161	128	139			
1949	219	199	209	187		162	173	242	210	169	187			
1950	199	186	200	164	141	139	169	227	200	149	173			
1951	176	164	175	152	139	129	151	189	172	190	165			
1952	174	158	175	157	132	133	155	181	168	193	160			
1953	191	185	204	185	140	146	186	221	194	171	182			

1/ Calculated from data in Table

2/ Calculated from average prices for two periods.

TABLE 7. UNIFORM PRICE IN SELECTED FEDERAL ORDER MARKETS AND PRICES PAID BY 18  
MIDWESTERN CONDENSERIES<sup>1/</sup> - 1940-1953  
(dollars per cwt. 3.5 milk)

Year	Uniform price								18 Cond- enseries <sup>2/</sup>
	Boston	New York	Chi- cago	New Orleans	Cincin- nati	Cleve- land	Minn.- St. Paul		
	\$	\$	\$	\$	\$	\$	\$	\$	\$
1940	1.38	1.90	1.72	1.95					1.35
1941	2.20	2.27	2.13	2.05					1.85
1942	2.53	2.68	2.52	2.59					2.07
1943	3.17	3.21	3.06	3.23	3.05				2.62
1944	3.23	3.34	3.10	3.30	3.21				2.64
1945	3.26	3.33	3.09	3.32	3.30				2.60
1946	4.00	4.09	3.98	4.02	3.85		3.81		3.45
1947	4.45	4.44	3.99	4.42	4.42	4.36	3.93		3.49
1948	5.16	5.13	4.60	5.11	4.92	4.93	4.40		3.97
1949	4.23	4.13	3.55	4.66	3.92	3.90	3.64		2.86
1950	4.05	4.00	3.46	4.75	3.87	3.83	3.59		2.95
1951	4.59	4.57	4.15	5.21	4.80	4.56	4.13		3.62
1952	4.79	4.64	4.51	5.50	5.06	4.78	4.43		3.78
1953	4.21	4.22	3.87	5.25	4.50	4.41	4.04		3.24
Margin Uniform over Condensery (dollars per cwt.)									
Aver.	\$	\$	\$	\$	\$	\$	\$	Average Margin	
								4 markets	7 markets
1940-46	0.54	0.61	0.43	0.56				0.53	--
1947-53	1.08	1.03	0.60	1.57	1.08	0.98	0.61	1.07	0.99
1940	0.53	0.55	0.37	0.60				0.51	
1941	0.35	0.42	0.28	0.22				0.32	
1942	0.56	0.61	0.45	0.52				0.54	
1943	0.55	0.59	0.44	0.61	0.43			0.55	
1944	0.59	0.70	0.46	0.66	0.57			0.60	
1945	0.66	0.73	0.49	0.72	0.70			0.65	
1946	0.55	0.64	0.53	0.57	0.40		0.36	0.57	
1947	0.96	0.95	0.50	0.93	0.93	0.87	0.44	0.84	0.80
1948	1.19	1.16	0.63	1.14	0.95	0.96	0.43	1.03	0.92
1949	1.37	1.27	0.69	1.80	1.06	1.04	0.78	1.28	1.14
1950	1.10	1.05	0.51	1.80	0.92	0.88	0.64	1.12	0.99
1951	0.97	0.95	0.53	1.59	1.18	0.94	0.51	1.01	0.95
1952	1.01	0.86	0.73	1.72	1.28	1.00	0.65	1.08	1.04
1953	0.97	0.98	0.63	2.01	1.26	1.17	0.80	1.15	1.12

<sup>1/</sup> Data supplied by the Dairy Division, United States Department of Agriculture.

<sup>2/</sup> Originally 18 condenseries; in recent years a smaller number.



## APPRAISAL OF CLASS I PRICES

In the preceding sections emphasis has been placed on the shifts that have taken place between Class I prices and the value of milk for manufacture, and between uniform prices and the condensery price. While these relationships show some of the historical changes that have taken place, other factors need consideration in appraising Class I prices and the results derived therefrom. While many factors need consideration in a complete appraisal, the following section will deal with three factors:

1. Federal Order Class I prices vs. Class I prices in nearby non-federal order markets.
2. Class I price compared with a competing source of supply.
3. Utilization in the market vs. supply available.

## FEDERAL ORDER CLASS I PRICES VS. NEARBY CLASS I PRICES

Boston and New York are federal order markets. In the Northeast, Providence, Rochester and Pittsburgh, are markets in which Class I prices are established by the respective state milk control agencies. The Boston and Providence milksheds overlap to some extent. The Rochester milkshed is contiguous to New York. In certain areas in Western Pennsylvania the Pittsburgh and New York milksheds are contiguous.

In 1941 the Class I prices in the 3 state-regulated markets averaged \$3.25, while the average for the 2 federally-regulated markets, Boston and New York, was \$2.70. The state-regulated markets exceeded the federal by \$0.55. The absolute difference between the two is not of special significance in this analysis. In this case, part of the difference is due to the fact that in the state-regulated markets the price is an f.o.b. city price, while for the federal markets it is a price applicable in the 201-210 mile zone. For the period 1940 to 1951 there was no persistent tendency for the margin between these two groups of markets to widen or to narrow. The state-regulated markets exceeded the federal by a minimum of \$0.23 and a maximum of \$0.55. From 1951 to 1953 the average Class I price in the state-regulated markets increased \$0.12, while the average federal Class I price declined \$0.41. In 1953 the state markets exceeded the federal by \$0.93. This was by far the widest margin on record, and more than double the average of the preceding 13 years, of \$0.39 (Table 8).

TABLE 8. CLASS I PRICES IN SELECTED FEDERAL ORDER MARKETS AND SELECTED NON-FEDERAL MARKETS IN SAME GENERAL GEOGRAPHIC AREA

1940-1953

(dollars per 100 pounds 3.5 milk)

	Northeast			Midwest			South		
	3 1/ non-federal	2 2/ federal	non-fed. exceeds federal	Des Moines	Chi-cago	Des Moines exceeds Chicago	Bir-mingham	New Orleans	Birming'm exceeds New Orl.
	\$	\$	\$	\$	\$	\$	\$	\$	\$
Av.									
1940-46	3.70	3.35	0.35	2.75	3.02	-0.27	3.73	3.04	0.69
Av.									
1947-53	5.80	5.29	0.51	4.64	4.25	+0.39	6.15	5.44	0.71
1940	2.96	2.60	0.36	2.00	1.94	+0.06	2.85	2.13	0.72
1941	3.25	2.70	0.55	2.10	2.37	-0.27	2.92	2.32	0.60
1942	3.55	3.14	0.41	2.60	2.74	-0.14	3.55	2.74	0.81
1943	3.85	3.52	0.33	3.00	3.32	-0.32	4.01	3.29	0.72
1944	3.86	3.63	0.23	3.00	3.34	-0.34	4.05	3.40	0.65
1945	3.86	3.63	0.23	3.00	3.30	-0.30	4.05	3.38	0.67
1946	4.59	4.23	0.36	3.55	4.15	-0.60	4.71	4.03	0.68
1947	5.39	4.92	0.47	4.39	4.16	+0.23	5.85	4.54	1.31
1948	5.90	5.66	0.24	4.96	4.78	+0.18	6.40	5.33	1.07
1949	5.77	5.28	0.49	4.62	3.77	+0.85	6.01	5.13	0.88
1950	5.40	4.99	0.41	4.09	3.68	+0.41	5.90	5.38	0.52
1951	5.94	5.54	0.40	4.67	4.39	+0.28	6.24	5.68	0.56
1952	6.17	5.52	0.65	5.02	4.81	+0.21	6.36	6.03	0.33
1953	6.06	5.13	0.93	4.73	4.16	+0.57	6.30	6.00	0.30

1/ Average of Providence, Rochester and Pittsburgh.

2/ Average Boston and New York.

A comparison of Chicago Class I prices with Des Moines shows that from 1940 to 1946 the Des Moines price averaged \$0.27 less than Chicago, while from 1947 to 1953 Des Moines averaged \$0.39 more than Chicago. In this case there was a marked rise in the non-regulated market in relation to the federally-regulated market (Table 8).

A comparison of Class I prices in Birmingham and New Orleans shows that during the early forties (1940-46) the Birmingham prices exceeded New Orleans by an average of \$0.69, and there was relatively little variation in the margin from year to year. In 1947 the margin widened abruptly, but since then the difference in the Class I prices in the two markets has narrowed phenomenally. In 1952 and 1953 the margin of Birmingham over New Orleans was less than half as great as in

the early forties (Table 8).

This brief comparison of prices in federally-regulated markets with nearby markets with state or no control does not indicate any standard pattern as regards the price relationship in the two types of markets. In the comparisons here given for the Northeast and Midwest, Class I prices in the non-federal markets in recent years were high compared to the federal Class I prices. In the South the margin in recent years has been less than in the early forties.

#### CLASS I PRICES COMPARED WITH COST OF COMPETING OR SUPPLEMENTARY SOURCE OF SUPPLY

Ordinarily there is little fluid milk shipped from the Midwest to the East. In the late forties, when Boston was short of milk, an emergency was declared and handlers were permitted to bring milk into the Boston market from plants outside the Boston milkshed. A considerable part of this "emergency milk" came from the Midwest.

In 1953 the Chicago Class I price at Shawano, Wisconsin, plus tank car freight to Boston, averaged \$5.73. At the same time, the Boston Class I price in the 201-210 mile zone, plus freight to Boston, averaged \$5.40. The Chicago order price in northern Wisconsin, plus freight to Boston, averaged \$0.33 higher than the Boston price (Table 9).

During the two years 1949 and 1950 the Boston price exceeded the Chicago price, plus freight, to Boston, by an average of \$0.27 per hundredweight of 3.5 milk. In recent years the Chicago price, plus freight, has averaged higher than the Boston price, but there were individual months when the Boston price was the higher. These months were confined, generally, to the fall and winter (Table 9).

In the above comparison it should be noted that Shawano, Wisconsin is on the northern edge of the Chicago milkshed and it carries a minus differential of \$0.22 from the Chicago 70-mile zone price. There are two plants in the Chicago pool located in Michigan.



The Chicago Class I price at Zeeland, Michigan is minus \$0.12 from the Chicago 70-mile zone price. Shawano is west of Lake Michigan and about 230 miles from Chicago, while Zeeland, Michigan is east of the lake and about 145 miles from Chicago. The latter city is about 225 miles by rail nearer to Boston than Shawano.

TABLE 9. CHICAGO CLASS I PRICE AT SHAWANO, WISCONSIN PLUS TANK CAR FREIGHT TO BOSTON, AND BOSTON CLASS I PRICE (201-210 MILE ZONE) PLUS TANK CAR FREIGHT TO BOSTON - 1940-1954<sup>1/</sup>  
(dollars per 100 pounds 3.5 milk)

Year	Shawano f.o.b. Boston <sup>2/</sup>	Boston f.o.b. Boston <sup>3/</sup>	Shawano exceeds Boston	Year	Shawano f.o.b. Boston	Boston f.o.b. Boston	Shawano exceeds Boston
1940	\$ 3.14	\$ 2.86	\$ 0.28	1947	\$ 5.46	\$ 5.25	\$ 0.21
1941	3.57	2.94	0.63	1948	6.34	6.02	0.32
1942	3.96	3.42	0.54	1949	5.42	5.67	-0.25
1943	4.57	3.78	0.79	1950	5.06	5.36	-0.30
1944	4.58	3.84	0.74	1951	5.77	5.81	-0.04
1945	4.54	3.84	0.70	1952	6.33	5.91	0.42
1946	5.41	4.42	0.99	1953	5.73	5.40	0.33

Year Jan. Feb. Mar. Apr. May June July Aug. Sept. Oct. Nov. Dec.

<u>Shawano price f.o.b. Boston</u>												
1951	\$5.45	\$5.71	\$5.78	\$5.85	\$5.50	\$5.44	\$6.00	\$5.96	\$5.95	\$5.89	\$5.92	\$5.83
1952	6.00	6.09	6.41	6.21	5.98	5.92	6.45	6.47	6.60	6.75	6.72	6.36
1953	6.08	5.88	5.83	5.77	5.42	5.34	5.81	5.77	5.78	5.79	5.83	5.47
1954	5.42	5.41	5.42	5.38	4.86							

<u>Boston price f.o.b. Boston</u>												
1951	5.62	5.62	5.62	5.63	5.63	5.41	5.63	5.85	5.85	6.29	6.28	6.27
1952	5.82	5.82	5.81	5.62	5.63	5.63	5.85	5.83	6.05	6.27	6.28	6.29
1953	5.86	5.86	5.42	4.77	4.77	4.77	4.99	5.20	5.64	5.86	5.86	5.87
1954	5.65	5.42	5.20	5.00	4.79							

<u>Margin Shawano over Boston</u>												
1951	-0.17	0.09	0.16	0.22	-0.13	0.03	0.37	0.11	0.10	-0.40	-0.36	-0.44
1952	0.18	0.27	0.60	0.59	0.35	0.29	0.60	0.64	0.55	0.48	0.44	0.07
1953	0.22	0.02	0.41	1.00	0.65	0.57	0.82	0.57	0.14	-0.07	-0.03	-0.40
1954	-0.23	-0.01	0.22	0.38	0.07							

<sup>1/</sup> Data supplied by C. W. Swonger.

<sup>2/</sup> Currently Chicago 70-mile price, less \$.22 to Shawano, plus \$1.79 tank car freight to Boston.

<sup>3/</sup> Currently Boston 201-210 mile price, less 2 points butterfat, plus \$.36 tank car freight to Boston.

Some valuable information on the cost of midwestern milk at eastern markets was compiled by the Boston market administrator for the period when the "emergency milk" was utilized in that market. For the six full months included in the



emergency periods of 1946-47 and 1947-48, Boston handlers obtained 25.5 million pounds of milk from outside the regular milkshed. This milk f.o.b. Boston cost an average \$6.76 per hundredweight. During the same period the Boston Class I price at Boston city plants averaged \$6.13. The cost of the emergency milk was \$0.63 more than the Class I price at Boston under the Boston order (Table 10).

During the same months that these emergency supplies were obtained in the Boston market, the condensery price (18) averaged \$4.42 (3.7 percent fat). This was \$2.34 less than the price of the emergency milk f.o.b. Boston. These prices indicate that during these two emergency periods the average cost of supplementary supplies f.o.b. Boston cost approximately \$2.35 more than the condensery price.

TABLE 10. VOLUME AND PRICE OF EMERGENCY MILK BROUGHT INTO THE BOSTON MARKET DURING 1946 AND 1947-48

Month	Volume of milk 1000 lbs. <sup>1/</sup>	Cost of emergency milk f.o.b. Boston per cwt. <sup>1/</sup>	Boston Class I price at city plants per cwt. <sup>2/</sup>	Price paid by condenseries per cwt. <sup>3/</sup>	Amount cost of emergency milk exceeded Boston Class I price per cwt.	Price paid by condenseries per cwt.
1946						
Nov.	6,155	\$ 6.62	\$ 6.09	\$ 4.81	\$ 0.53	\$ 1.81
Dec.	2,221	6.49	6.09	4.55	0.40	1.94
1947-48						
Nov.	6,688	6.78	6.14	4.02	0.64	2.76
Dec.	6,445	6.86	6.14	4.38	0.72	2.48
Jan.	2,356	6.87	6.14	4.56	0.73	2.31
Feb.	<u>1,654</u>	7.01	6.17	<u>4.42</u>	0.84	<u>2.59</u>
Weighted av.	<u>4,253</u>	6.76	6.13	<u>4.42</u>	0.63	2.34

1/ Compiled from reports of the Boston Market Administrator. The first emergency period was from October 20, 1946 to January 19, 1947, and the second from October 29, 1947 to March 3, 1948. The data here given are only for the full months in each emergency period. The prices are on a 3.7 percent butterfat basis.

2/ Compiled from reports of the Boston Market Administrator. Based on 3.7 milk.

3/ Price paid by 18 condenseries, adjusted to a 3.7 percent basis by multiplying the reported prices on a 3.5 basis by 1.057 ( $3.7 \div 3.5 = 1.057$ ).

During the period this emergency milk was brought in it was a common practice for handlers to pay premiums over the minimum uniform price established by the order. Thus, the difference between the price actually paid for the emergency milk, as contrasted with prices actually paid for milk priced under the Boston order, was not as great as these data indicate. The price comparison noted above is simply the difference between the cost of the emergency milk and the Class I price under the Boston order.

As long as Class I prices in the Northeast are less than the midwestern condensery price plus the cost of getting midwestern milk to eastern markets, consumers could not get cheaper milk even if milk were obtained from such sources. With prices at that level, northeastern producers have little to fear from midwestern competition in the fluid markets. In some respects the midwestern condensery price plus the cost of getting milk to eastern markets plus some premium for quality, might be considered as a ceiling on Class I prices in the Northeast.

In each of the years 1940 to 1948 the Boston Class I price at city plants was significantly less than the condensery price plus \$2.35. In 1949, however, the Boston Class I price exceeded the condensery price plus \$2.35 by a significant amount, \$0.60. From 1951 to 1953, however, the differences on an annual basis have been insignificant (Table 11).

TABLE 11. BOSTON CLASS I PRICE AT CITY PLANTS AND MIDWESTERN CONDENSERY PRICE PLUS \$2.35, 1940-53  
(dollars per 100 pounds 3.7 milk)

Year	Boston Class I price	Condensery price plus \$2.35	Amount cond. price exceeds Boston Class I
1940	\$ 3.16	\$ 3.78	\$ 0.62
1941	3.24	4.30	1.06
1942	3.70	4.54	0.84
1943	4.05	5.12	1.07
1944	4.10	5.14	1.04
1945	4.10	5.10	1.00
1946	4.73	5.99	1.26
1947	5.56	6.04	0.48
1948	6.37	6.55	0.18
1949	5.97	5.37	-0.60
1950	5.66	5.46	-0.20
1951	6.13	6.17	+0.04
1952	6.24	6.34	+0.10
1953	5.71	5.77	+0.06

During the 7-year period 1947-1953 there were months when the midwestern condensery price plus \$2.35 was decidedly higher than the Boston Class I price at city plants (Figure 3). In some of these months the Boston market was short of milk. On the other hand, there were a considerable number of months when the Boston Class I price at city plants was higher than the condensery price (plus \$2.35). During the 7-year period as a whole these two price series were inter-

twined (Figure 3). There was no consistent long-time tendency for one to rise in relation to the other or to fall in relation to the other (Figure 3).

#### NEW ORLEANS

The prices of milk purchased from producers under Order No. 42, f.o.b. plants in New Orleans, were compared with prices of Grade A, 4 percent milk purchased from alternative sources (Table 12). From 1945 to 1948 there was a wide disparity between the two. The order price averaged \$1.72 per hundredweight less than the cost of the other source milk.

During the 9-year period, however, the general tendency has been for the disparity between the two prices to narrow, and in 1953 they were practically identical (Table 12).

In the last decade, both Boston and New Orleans markets showed a marked shift in the relationship between the order price of Class I milk and the cost of supplementary or competing supplies. In the earlier years the order prices were less than the cost of other supplies. In 1953, however, the order price and cost of other supplies were practically identical in each of the two markets.

#### SHIFT IN MILKSHED

The preceding examples compare the price of milk in one market with the cost of going outside the regular supply area and obtaining supplementary supplies. When shortages develop suddenly and there are also shortages in nearby markets this is often what handlers actually do. However, over longer periods adjustments are often made in the boundaries of the milkshed.

An example of the shift in the boundaries of the milkshed is the contraction of the New York milkshed in the western part of New England and the expansion in central and southern Pennsylvania. The receipts of milk at New York pool plants in these two areas in the early forties and the early fifties, in millions of pounds per year, were as follows:

	New England	Pennsylvania	Total 2 areas.
Average 1941-42	312	352	664
Average 1951-52	<u>164</u>	<u>517</u>	<u>665</u>
Change	-164	+165	+ 1



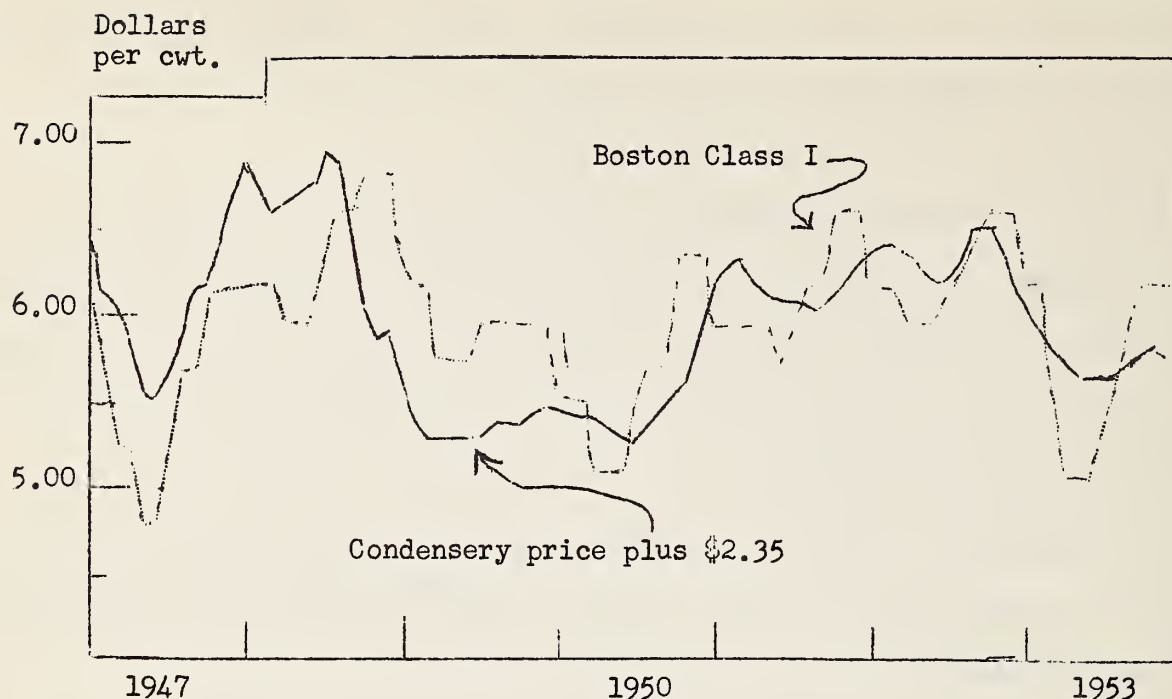


FIGURE 3. BOSTON CLASS I PRICE F.O.B. CITY PLANTS AND MIDWESTERN CONDENSERY PRICE PLUS \$2.35 - 1947-1953.

In some months the condensery price plus \$2.35 exceeded the Boston price, while in others the reverse was true. There was no consistent long-time tendency for either price to increase or decrease in relation to the other.

TABLE 12.- ORDER NO. 42 CLASS I PRICE F.O.B. NEW ORLEANS AND COST OF MILK FROM ALTERNATIVE SOURCES - 1945-1953 1/

(dollars per cwt.)			
Year	Class I f.o.b. New Orleans Order No. 42 4% milk	Other source milk 4% 1/	New Orleans order price exceeds other sources
1945	\$3.98	\$5.82	\$ - 1.84
1946	4.69	6.77	- 2.08
1947	5.25	6.83	- 1.58
1948	6.11	7.48	- 1.37
1949	5.90	6.38	- 0.48
1950	6.16	6.30	- 0.14
1951	6.49	7.10	- 0.61
1952	6.88	7.66	- 0.78
1953	6.85	6.81	+ 0.04

1/ "Prices of Grade A 4 percent milk purchased from alternative sources. In some instances the price of other source milk represents the best estimate of the Market Administrator of what it would have cost during periods when there were no outside purchases by New Orleans handlers." (From letter to E. E. Vial from W. H. Alexander.)



In the decade the loss in average annual receipts of 164 million pounds in New England was balanced by a gain of an equivalent amount in central and southern Pennsylvania. The New York milkshed was pushed westward.

#### RELATIONSHIP OF MARKET REQUIREMENTS AND MARKET SUPPLY

The most important single objective in the pricing of Class I milk is to obtain an adequate supply of milk for the market. Thus, the changes in the relationship between the use of fluid milk in the market and the supply on the market are of primary importance in appraising Class I prices. Some markets require their supplies of fluid cream to come from the same type of plants as the supplies of fluid milk. Under such circumstances it is the volume of milk used as fluid milk and fluid cream that is the measure of market requirements.

The total receipts of milk from producers at plants in the Boston pool in 1940 and 1953 were 1,173 and 1,599 million pounds, respectively. The increase amounted to 36 percent. The volume of this milk utilized for Class I in the two years was 621 and 837 million pounds, respectively. Requirements for fluid milk increased 35 percent. The utilization of receipts from producers in Class I required 52.9 percent of the supply in the earlier year and 52.8 percent in the latter. Thus, the market was equally well supplied with milk in both years on an annual basis. Even though market requirements had shown a marked expansion, the supply had increased in proportion to the requirements.

The changes in the percentage of receipts utilized to supply the market requirements is an accurate, readily available and sensitive measure which shows whether fluid requirements are rising or falling in relation to the supply.

During the past 15 years there have been striking changes in the proportion of the supply utilized to fill market requirements in federal order markets (Table 13, Figure 4). Figure 4 shows in vivid fashion that during the early

TABLE 13. PERCENTAGE OF PRODUCER RECEIPTS UTILIZED FOR FLUID MARKET REQUIREMENTS  
SELECTED FEDERAL ORDER MARKETS<sup>1/</sup> 1938-53  
(Percent)

Chicago Class I & II	New York 2/ 3/		Boston Class I	New Orleans Class I	Minn.- St. Paul Class I	Cincin- nati Cl. I & II	Cleve- land Class I
1938			61.2				
1939			56.9				
1940	81.1	57.8 63.0	52.9	78.9			
1941	78.4	56.6 61.3	54.5	68.2			
1942	79.8	53.3 59.6	58.4	81.9			
1943	78.7	53.3 62.7	65.9	89.5		81.6	
1944	77.6	56.6 64.1	64.4	88.3		81.6	
1945	81.9	57.9 65.6	66.1	90.4		78.7	
1946	93.1	65.8 75.0	76.2	96.4	59.0	80.2	
1947	85.3	64.7 71.6	65.0	88.9	59.1	75.8	80.9
1948	82.5	65.3 72.1	65.8	86.7	61.6	74.1	77.3
1949	73.0	57.1 63.2	55.8	80.0	59.8	67.6	72.2
1950	71.7	53.8 60.8	54.7	76.8	59.0	65.4	71.9
1951	76.3	53.7 61.4	56.4	81.1	61.8	69.1	75.6
1952	73.4	52.5 60.0	57.6	80.4	62.8	68.2	68.4
1953	63.2	49.1 56.6	52.8	76.9	58.5	63.3	66.1

<sup>1/</sup> Data supplied by the Dairy Division, United States Department of Agriculture.  
In some markets emergency milk was used for fluid market requirements, but it was not included in the calculation of the above percentages.

<sup>2/</sup> Class I-A and Class II.

<sup>3/</sup> Classes I-A, I-B, I-C and II.

forties there were marked increases in fluid requirements in relation to supply. Acute shortages developed. In many markets the utilization percentages reached all-time highs in 1946.

A preceding section of this report shows that the margin of Class I price over the condensery price during the period 1940-46 averaged decidedly lower than in the period 1947-1953, and also that the margin of the blend price over the condensery price was much lower from 1940-46 than from 1947-53. The data on the percentage utilization indicates that the prices in effect from 1940-46 were not high enough to furnish an adequate supply.

The rapid increase in the percentage of the supplies utilized for fluid requirements in the early forties was followed by equally rapid declines in the late forties and fifties. It is clear that during the period 1947-53 the supply of milk in these markets increased more rapidly than market requirements.

In general, the percentages rose during the early forties and declined during the late forties and early fifties.

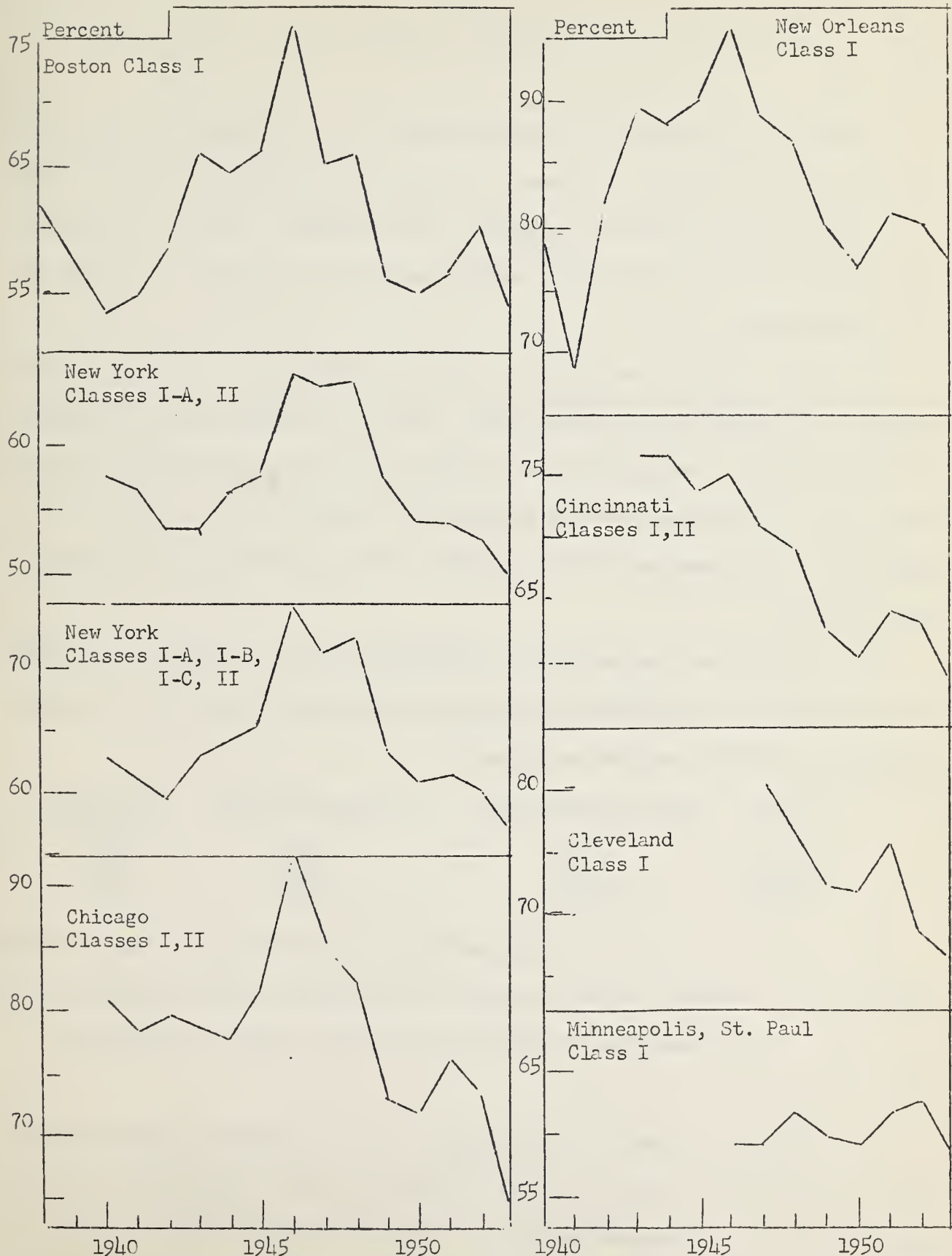


FIG. 4. PERCENTAGE OF RECEIPTS OF MILK FROM PRODUCERS UTILIZED FOR FLUID MARKET REQUIREMENTS IN SELECTED FEDERAL ORDER MARKETS - 1937-1953.



The Minneapolis-St. Paul market was the only one of the selected markets which did not show a decided shift in the relation of supply to market requirements (Figure 4).

Because of the shortages in the mid-forties it was absolutely essential that supplies in many markets be increased in relation to market requirements so that the markets could be adequately supplied. With the Class I and blend prices in effect during the period 1947-1953, market supplies did increase in relation to fluid requirements.

The data in Table 13 and Figure 4 show the percentage of receipts utilized for fluid requirements on an annual basis. There is a marked seasonal variation in this percentage. During the period 1943 to 1947 over 90 percent of the November receipts in the Boston pool were utilized for Class I, while only about 50 percent of the May receipts were so utilized. For New York the variation was much the same.

During the 14-year period 1940 to 1953 the percentage of receipts utilized for market requirements at the long and short seasons for three of the selected federal order markets averaged as follows:

Market	Short season (Nov.)	Long season (May)	Difference
Boston	78.5	44.9	33.6
New York	83.1	48.6	34.5
Chicago	90.7	70.1	20.6

For both Boston and New York the percentage of the supply utilized for market requirements in the short season was about 34 percentage points higher than in the long season. For Chicago the difference was much less - only 21 percentage points (Figure 5).

The principal problem in pricing Class I milk is to have an adequate supply at all seasons of the year. In order to adequately serve a fluid market there is a requirement for a "necessary surplus." In some markets the trade considers that a surplus of about 20 percent of the market requirements is necessary in



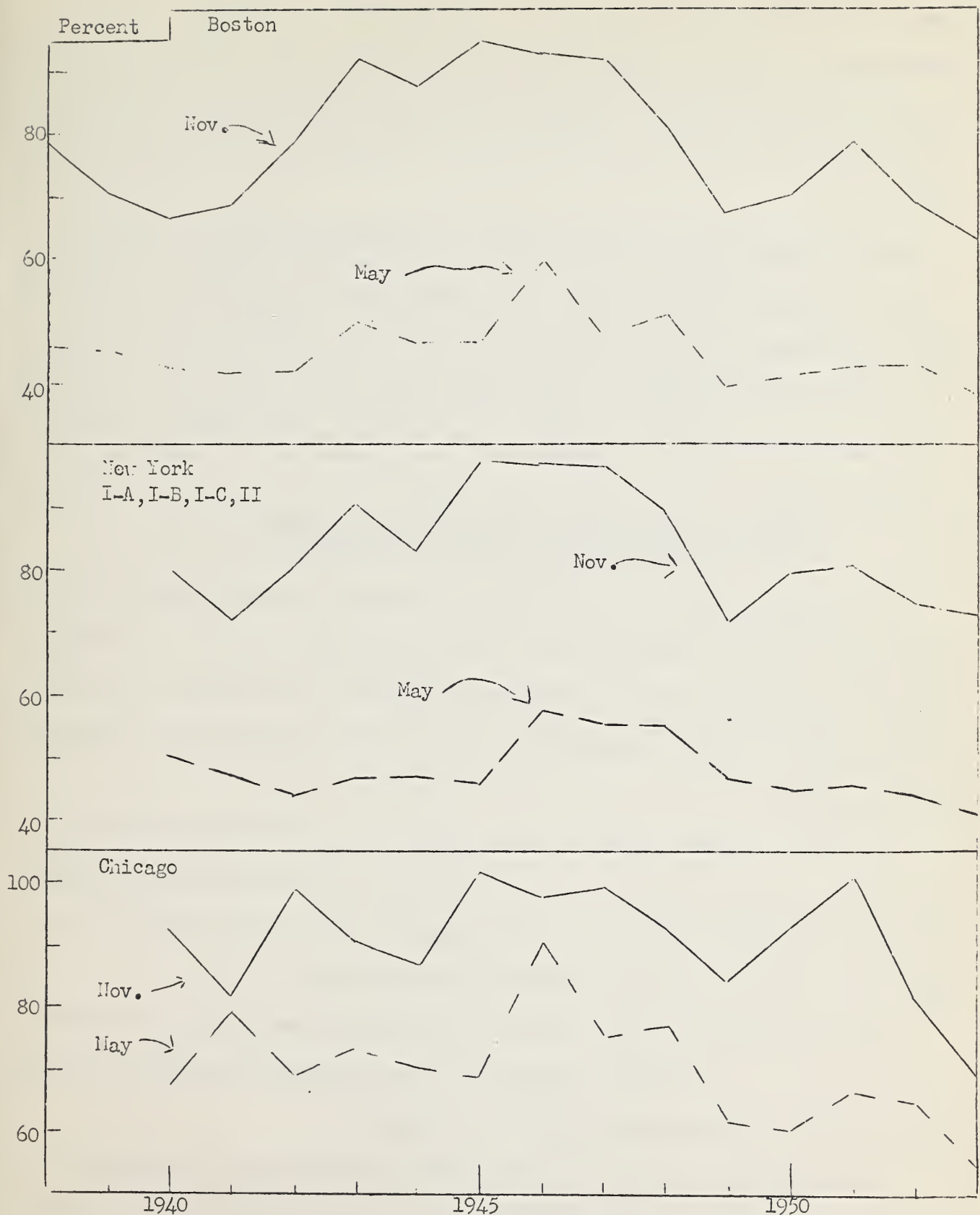


FIGURE 5. PERCENTAGE OF RECEIPTS OF MILK FROM PRODUCERS UTILIZED FOR FLUID MARKET REQUIREMENTS IN MAY AND NOVEMBER, BOSTON, NEW YORK AND CHICAGO-1938-53.

The percentage utilized for market requirements in November was always much higher than in May in each of the markets. In recent years the percentage utilization in November was relatively low.

order to adequately service the market. This percentage of necessary surplus no doubt varies from market to market. One way of measuring when a market shifts from an adequate to an excessive or burdensome supply is to determine the percentage of actual surplus in the short month in relation to the percentage of "necessary surplus."

When an order first goes into effect the percentage of supply utilized for fluid requirements probably reflects, in a general way, the adjustment of supply to market requirements which was achieved under the prior competitive conditions. In these selected markets which have had federal orders since 1940, the 1953 relationship of supply and market requirements was not as good as when federal regulation was first started.

#### RELATIONSHIP OF CLASS I CONDENSERY PREMIUM TO PERCENTAGE UTILIZATION FOR MARKET REQUIREMENTS

In preceding sections of this report it was shown (1) that the premium of the Class I price over the condensery price has varied greatly from year to year, and (2) that the percentage of market supplies utilized for fluid market requirements has also varied greatly. The question arises as to what has been the relationship between the two.

It might be expected that (1) when a market is short of milk the Class I price would be high in relation to the prices paid for milk for manufacture, and (2) when a relatively small portion of the supply is so used the premium of the Class I price over the manufacturing value would be low.

During World War II prices were not free to move because of price controls. In determining the relationship between the Class I-condensery premium and utilization the 7-year postwar period 1947-1953 was used.

The relationship for the 7 selected federal order markets is portrayed in graphic form in Figure 6. The horizontal scale is the percentage of receipts in each market utilized for market requirements (the data are shown in Table 13). The vertical scale is the premium of the Class I price over the condensery price

(the data are from Table 3). The dot on the chart for each year shows the utilization percentage for the year and the premium of the Class I over the condensery price for the same year. The straight line indicates the average relationship for the 7-year period.

First, it is abundantly clear that there was very little relationship between these factors in any of the markets, with the possible exception of New Orleans. The variations in the Class I premium over the condensery price seemed to vary almost independently of the percentage of supplies utilized for fluid requirements in the respective markets. Secondly, what little relationship there was seemed to indicate that, on the average, there was a slight tendency for the Class I-condensery price premium to be greatest when the utilization was below average.

For example, for New York the 4 years with the largest proportion of receipts utilized to supply market requirements were 1946, 1947, 1949 and 1951. During these 4 years the percentage averaged 66.9 as compared to 59.1 percent for the three years with the lowest percentage utilization. In the years with the high utilization the New York Class I-A price averaged \$1.88 higher than the condensery price, compared with \$1.92 in those years when the percentage was lowest. The margin of the I-A over the condensery price was slightly higher in those years when the utilization was lowest.

The average percentage of receipts utilized for market requirement for the 4 years with the highest utilization and the three years with the lowest utilization, together with the premium of the Class I price over the condensery price for the selected federal order markets, are summarized as follows:

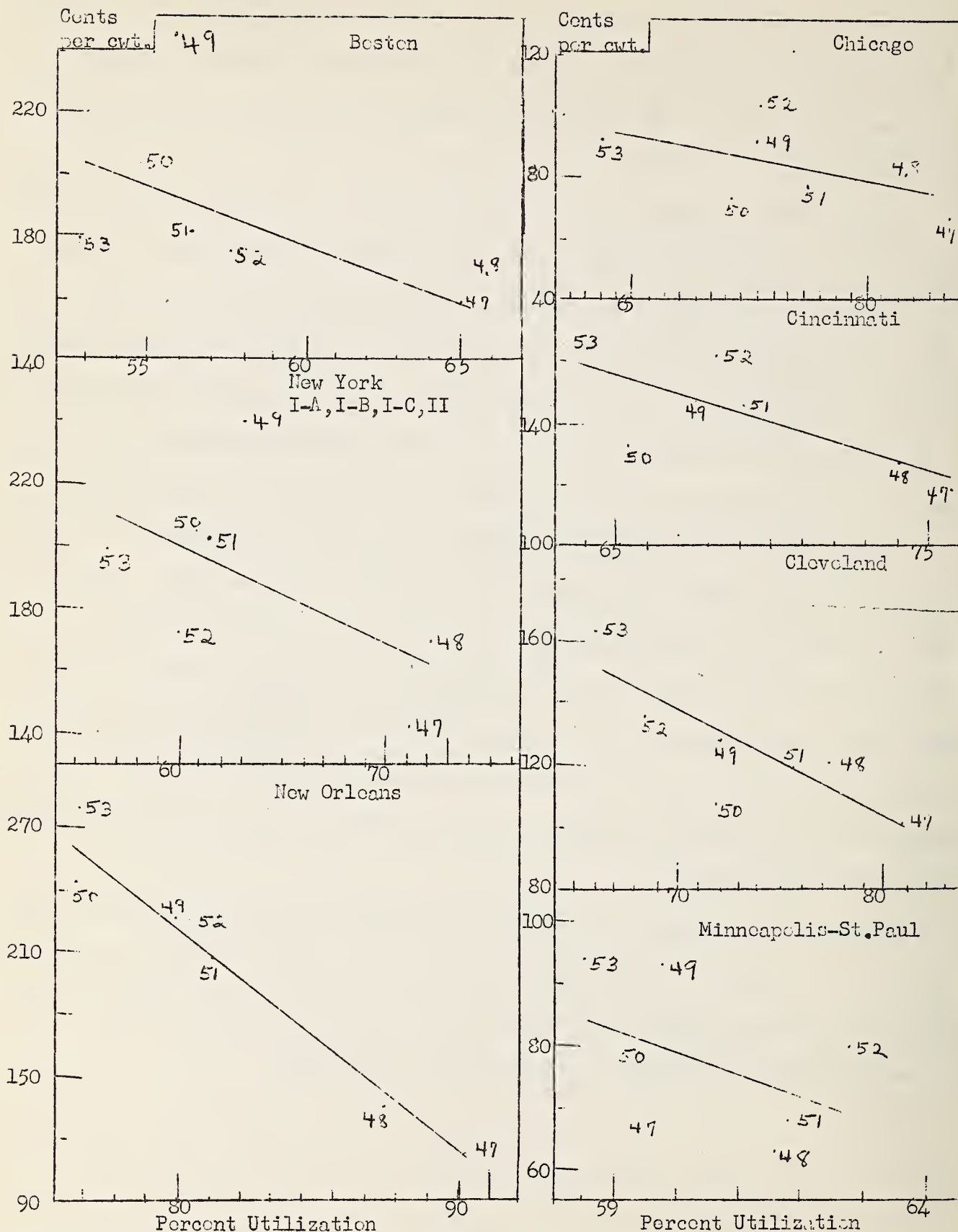


FIGURE 6 RELATIONSHIP BETWEEN CLASS I CONDENSERY PRICE PREMIUM AND PERCENTAGE UTILIZATION FOR MARKET REQUIREMENT, 7 SELECTED MARKETS, 1947-1953.

There was little relationship between the two factors. There was some tendency for the premium to be greatest when utilization was lowest.



Market	<u>Percent utilization</u>			<u>Premium of Class I over condensery price</u>		
	4 high years percent	3 low years percent	High exceeds low	4 high utili- zation years	3 low utili- zation years	Low exceeds high
Boston	61.2	54.4	6.8	\$1.67	\$2.09	\$0.42
New York (I-A, I-B, I-C, II)	66.9	59.1	7.8	1.88	1.92	0.04
Cleveland	76.5	68.8	7.7	1.17	1.36	0.19
Cincinnati	71.8	65.4	6.4	1.39	1.49	0.10
Chicago	79.4	69.3	10.1	0.82	0.85	0.03
Minneapolis-St. Paul	61.5	58.9	2.6	0.76	0.80	0.04
New Orleans	84.3	77.9	6.4	1.68	2.49	0.81

In each case the premium of the Class I price over the condensery price averaged somewhat higher in those years when the utilization was lowest.

At the present time most federal order Class I price formulas contain a "supply-demand factor." This part of the formula operates to reduce the Class I price when supplies increase in relation to market requirements and to raise the Class I price when supplies decline in relation to market requirements. This type of formula has been in widespread use in federal orders for only a relatively short period of time. There are inevitable lags in the adjustment of production and consumption to price changes. The relationships between the percentage of receipts utilized for market requirements and the premium of the Class I price over the condensery price indicate that for the period 1947 to 1953 there was no tendency for the premium of the Class I price over the condensery price to be lowest when the percentage utilization for market requirements was lowest. In the above comparison the Class I premium for a given year was compared with utilization the same year. No attempt was made to measure the longer time adjustments.

#### NORTHEAST - CLASS I SALES VS. PRODUCTION

Over a period of years the receipts from producers at plants subject to a particular order do not necessarily reflect changes in production. There are cases where the larger markets with marketwide pools have absorbed the surplus from secondary and nearby markets. Furthermore, the gains or losses in receipts due to variations in the number of producers and the number of plants do not reflect changes in production. It is difficult to determine whether the changes in production of producers delivering to plants under regulation differ significantly

In the Northeast the general level of producer returns is greatly affected by the blend prices in the large federally regulated markets of Boston, New York and Philadelphia. The volume of Class I milk in 11 northeastern markets was compiled for the period 1940 to 1953 in order to obtain a measure of the major changes in Class I sales in the Northeast. The 11 markets were Boston, Rhode Island, Connecticut, New York City, North Jersey, South Jersey, Philadelphia, Baltimore, Pittsburgh (Allegheny County), Buffalo (Niagara Frontier milk marketing area) and Rochester. These markets include the largest in the Northeast, and probably give a fairly reliable index of the major changes in the Class I volume in the Northeast (Table 14).

TABLE 14. CLASS I SALES 11 NORTHEASTERN MARKETS AND TOTAL MILK PRODUCTION ON FARMS  
9 NORTHEASTERN STATES - 1940-1953

	Class I (11 markets) <sup>1/</sup> (million pounds)	Total Milk Production <sup>2/</sup> (million pounds)	Class I Percent of Total
1940	5,897	17,351	34.0
1941	6,164	17,832	34.6
1942	6,588	18,244	36.1
1943	7,141	17,678	40.4
1944	7,441	18,013	41.3
1945	7,747	18,716	41.4
1946	8,089	18,012	44.9
1947	7,946	18,563	42.8
1948	7,798	18,132	43.0
1949	7,817	19,503	40.1
1950	7,834	19,719	39.7
1951	7,961	19,584	40.7
1952	8,128	19,938	40.8
1953	8,198	20,876	39.3

<sup>1/</sup> The 11 markets include Boston, Rhode Island, Connecticut, New York City, North Jersey, South Jersey, Philadelphia, Baltimore, Pittsburgh (Allegheny County), Buffalo (Niagara Frontier marketing area) and Rochester. The Class I sales were obtained from the respective milk control agencies, except for Pittsburgh. For that market, they were compiled from publications and reports of the Department of Agricultural Economics and Rural Sociology, Pennsylvania State University.

<sup>2/</sup> Total for 6 New England and 3 Middle Atlantic states.

The total volume of Class I sales in these 11 markets totaled 5,897 million pounds in 1940. It increased each year until a peak of 8,089 million pounds was reached in 1946. During the period 1940 to 1946 the Class I volume increased 37 percent, but total milk production on farms in the Northeast increased only 4 percent (Table 14).

The trends from 1946 to 1953 were nearly the reverse of the earlier period. There were some declines in the total Class I volume in 1947 and 1948, followed by moderate increases, and by 1953 the total Class I volume in the 11 markets was only 1.3 percent larger than in 1946. On the other hand, the general trend in milk production on farms was decidedly on the upswing. From 1946 to 1953 the increase was 16 percent. In 1946 the Class I sales in these 11 markets were 45 percent as large as total production in the Northeast, as compared with 39 percent in 1953 (Table 14).

The relationship of Class I sales to total milk production in the Northeast remained practically unchanged in the 5 years 1949-53. The Class I percentage has been lower than during the period of wartime full shortages, but higher than in the early forties.

During the early forties Class I sales in the Northeast increased much faster than production, and shortages developed. During the late forties and early fifties, production increased much faster than Class I sales, the shortages were eliminated, and surpluses developed.

The major changes in the percentage that Class I sales in the 11 markets were of total production in the Northeast, can be summarized as follows:

	Year	Percentage
Low of early forties	(1940)	34.0
High	(1946)	44.9
Low of postwar period	(1953)	39.3

#### CREAM RECEIPTS AT EASTERN MARKETS FROM NORTHEAST AND MIDWEST

The cream received at the three principal eastern markets is used primarily for fluid use and for ice cream. Ordinarily, most of the cream received at these markets comes from the Northeast, but considerable quantities are also obtained from the Midwest.



When milk production in the Northeast is large in relation to the consumption of fluid milk, large supplies of milk are available to supply the fluid cream and ice cream requirements of the area. Conversely, when milk supplies in the Northeast are short, receipts from the Midwest increase.

TABLE 15. TOTAL RECEIPTS OF CREAM AT BOSTON, NEW YORK AND PHILADELPHIA FROM NORTHEAST AND MIDWEST - 1930-1953<sup>1/</sup>  
(1000 40-qt. cans of 40 percent cream)

Year	Total	Northeast <sup>2/</sup>	Midwest <sup>3/</sup>	Percent of Total	
				Northeast	Midwest
1930	2,818	2,413	405	85.6	14.4
1931	2,821	2,380	441	84.4	15.6
1932	2,654	2,198	456	82.8	17.2
1933	2,381	1,936	445	81.3	18.7
1934	2,367	2,030	337	85.8	14.2
1935	2,236	1,889	347	84.5	15.5
1936	2,291	1,958	333	85.5	14.5
1937	2,341	1,930	411	82.4	17.6
1938	2,259	1,883	376	83.4	16.6
1939	2,391	2,091	300	87.5	12.5
1940	2,329	2,005	244	89.5	10.5
1941	2,363	1,992	371	84.3	15.7
1942	2,199	1,832	367	83.3	16.7
1943	1,506	1,164	342	77.3	22.7
1944	1,590	1,153	437	72.5	27.5
1945	1,860	1,245	615	66.9	33.1
1946	2,420	1,190	1,230	49.2	50.8
1947	2,076	1,332	744	64.2	35.8
1948	1,748	1,177	571	67.3	32.7
1949	1,786	1,493	293	83.6	16.4
1950	1,935	1,657	278	85.6	14.4
1951	1,776	1,503	273	84.6	15.4
1952	1,731	1,492	239	86.2	13.8
1953	2,349	2,198	151	93.6	6.4

<sup>1/</sup> Compiled from reports of the Agricultural Marketing Service.

<sup>2/</sup> Includes 6 New England states, 3 Middle Atlantic States and Maryland, Delaware and Virginia, and Canada.

<sup>3/</sup> All states not included in Northeast.

Total receipts of cream at the three principal markets were fairly stable from 1933 to 1941 (Table 15, Figure 7). During the war period they were low, when there were restrictions on the sale of cream and the use of butterfat in ice cream. After the end of wartime control there was a short-lived recovery in receipts, and in 1953 there was a marked gain.



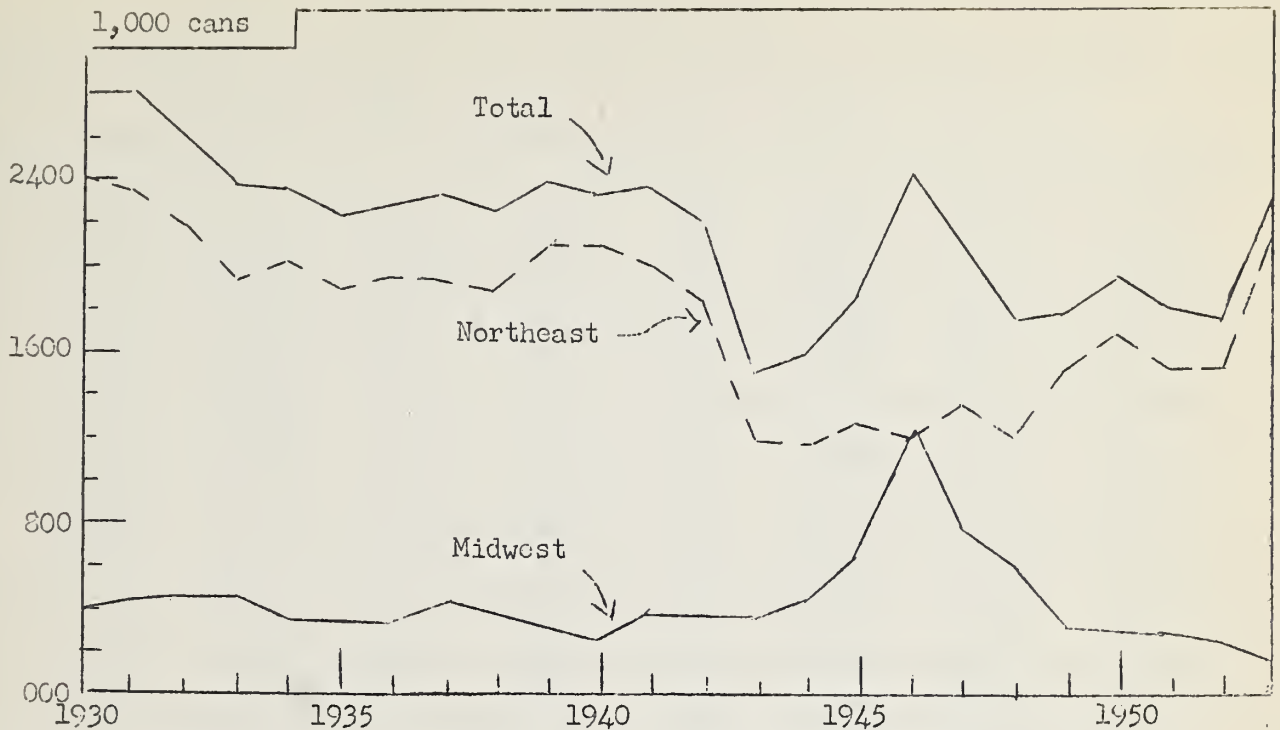


FIGURE 7. RECEIPTS OF CREAM AT BOSTON, NEW YORK AND PHILADELPHIA MARKETS FROM NORTHEASTERN AND MIDWESTERN STATES - 1930-1953

Most of the receipts of cream are ordinarily from the Northeast. There was a phenomenal increase in receipts from the Midwest from 1943 to 1946, and a marked decline since then.

Receipts from the Northeast tended to parallel total receipts, except for the war period. From 1943 to 1946 there was a phenomenal increase in receipts of western cream at eastern markets, and in 1946 exceeded those from the Northeast. Since 1946 the general trend in midwest receipts has been downward, and in 1953 they reached the lowest level on record.

## MILK PRODUCTION BY AREAS

Over the years there have been shifts in the relative importance of different areas in the United States in the volume of milk production. In 1924, milk production in the United States totaled 89,240 million pounds. In that year, production in the 9 northeastern states was 18.0 percent of the total. This was the highest proportion of the total production in the Northeast in the 3 decades for which data are available. From 1924 to 1943 the general tendency was for the Northeast to lose position. In 1943, only 15 percent of the total was produced in the Northeast. Since then, there has been some recovery, and during the fifties a little over 17 percent was produced in this area. This was the highest proportion in many years, but still less than in 1924 and 1925 (Tables 16 and 17).

The East North Central States are the leading production area. Not only is this area the one of heaviest production, but its relative importance has increased. During the early thirties this area produced about 26.5 percent of the milk, and in the fifties, nearly 30 percent.

In striking contrast to the East North Central States, the West North Central have lost position. Even though this area ranks second in volume of production, it produced about 22 percent of the total in the fifties as compared with 27 percent in the early thirties (Table 17 and Figure 8).

The total production of milk in the South Atlantic States is the smallest for any section of the country. In the last decade, however, production in this area has gained somewhat in relation to the total, from about 6 percent to 7 percent. The South Central States gained in importance from the twenties to the late thirties, but since then have lost about all the gain. The relative importance of the Western States has been practically constant since the thirties.

Wisconsin is the leading state in milk production, and, during the last three decades, its relative importance has increased. During the twenties, 11.3 percent of the milk was produced in Wisconsin, as compared with 13.1 percent in the fifties.

TABLE 16. MILK PRODUCTION ON FARMS BY GEOGRAPHIC AREAS - 1924-1953<sup>1/</sup>  
(million pounds)

Year	Total	North- east	East North Central	West North Central	South At- lantic	South Central	Western Wisconsin
1924	89,240	16,036	25,257	22,420	5,559	10,654	9,314
1925	90,699	15,869	25,673	23,126	5,517	10,913	9,601
1926	93,325	15,748	26,082	23,944	5,712	12,079	9,760
1927	95,172	15,681	25,903	24,553	5,935	12,812	10,288
1928	95,843	15,565	25,695	25,398	5,895	12,878	10,412
1929	98,988	15,582	26,640	26,515	5,899	13,431	10,921
1930	100,158	15,948	26,919	27,135	5,729	13,183	11,197
1931	103,029	16,414	27,612	27,829	6,020	13,854	11,300
1932	103,810	16,276	27,550	28,090	6,137	14,450	11,307
1933	104,762	16,194	27,608	29,046	6,176	14,439	11,299
1934	101,528	15,948	27,313	26,806	6,209	14,004	11,248
1935	101,205	16,072	27,456	26,074	6,242	14,049	11,312
1936	102,410	16,418	28,279	25,854	6,262	14,088	11,509
1937	101,908	16,517	28,099	24,950	6,350	14,518	11,474
1938	105,807	16,629	29,197	26,549	6,438	15,181	11,813
1939	106,792	16,681	29,538	26,857	6,560	14,947	12,209
1940	109,412	17,351	30,621	27,678	6,597	14,515	12,650
1941	115,008	17,832	32,404	29,266	6,900	15,480	13,206
1942	118,533	18,244	33,743	29,978	7,080	16,036	13,452
1943	117,017	17,678	32,984	29,776	7,162	15,968	13,449
1944	117,023	18,013	33,309	28,573	7,318	16,122	13,688
1945	119,828	18,716	35,328	28,465	7,552	16,059	13,708
1946	117,697	18,012	34,939	28,317	7,553	15,360	13,516
1947	116,814	18,563	34,692	27,443	7,667	14,978	13,471
1948	112,671	18,132	33,401	26,006	7,698	14,416	13,018
1949	116,103	19,503	34,739	26,218	7,986	14,696	12,961
1950	116,602	19,719	34,405	26,269	8,139	14,925	13,145
1951	114,841	19,584	34,126	25,687	8,102	14,450	12,892
1952	115,197	19,938	34,679	25,210	8,171	14,244	12,955
1953	121,219	20,876	36,301	26,509	8,592	15,116	13,825

<sup>1/</sup> Compiled from reports of the Agricultural Marketing Service, United States Department of Agriculture.

TABLE 17. MILK PRODUCTION ON FARMS BY GEOGRAPHIC AREAS EXPRESSED AS A PERCENTAGE OF TOTAL PRODUCTION - 1924-1953<sup>1/</sup>

Year	North-east percent	East North Central percent	West North Central percent	South Atlantic percent	South Central percent	Western percent	Wisconsin percent
1924	18.0	28.3	25.1	6.2	11.9	10.4	11.3
1925	17.5	28.3	25.5	6.1	12.0	10.6	11.6
1926	16.9	27.9	25.7	6.1	12.9	10.5	11.5
1927	16.5	27.2	25.8	6.2	13.5	10.3	11.2
1928	16.2	26.8	26.5	6.2	13.4	10.9	11.0
1929	15.7	26.9	26.8	6.0	13.6	11.0	11.2
1930	15.9	26.9	27.1	5.7	13.2	11.2	11.2
1931	15.9	26.8	27.0	5.8	13.4	11.0	11.0
1932	15.7	26.5	27.1	5.9	13.9	10.9	10.6
1933	15.5	26.4	27.7	5.9	13.8	10.8	10.4
1934	15.7	26.9	26.4	6.1	13.8	11.1	10.5
1935	15.9	27.1	25.8	6.2	13.9	11.2	10.8
1936	16.0	27.6	25.2	6.1	13.8	11.2	11.3
1937	16.2	27.6	24.5	6.2	14.2	11.3	11.2
1938	15.7	27.6	25.1	6.1	14.3	11.2	11.2
1939	15.6	27.7	25.1	6.1	14.0	11.4	11.2
1940	15.9	28.0	25.3	6.0	13.3	11.6	11.6
1941	15.5	28.2	25.4	6.0	13.5	11.5	11.8
1942	15.4	28.5	25.3	6.0	13.5	11.3	12.0
1943	15.1	28.3	25.4	6.1	13.6	11.5	12.0
1944	15.4	28.5	24.4	6.3	13.8	11.7	12.0
1945	15.6	29.5	23.8	6.3	13.4	11.4	12.5
1946	15.3	29.6	24.1	6.4	13.1	11.5	12.7
1947	15.9	29.7	23.5	6.6	12.8	11.5	12.9
1948	16.1	29.6	23.1	6.8	12.8	11.6	12.8
1949	16.8	29.9	22.6	6.9	12.7	11.2	12.9
1950	16.9	29.5	22.5	7.0	12.8	11.3	12.7
1951	17.1	29.6	22.4	7.1	12.6	11.2	13.1
1952	17.3	30.1	21.9	7.1	12.4	11.2	13.3
1953	17.2	29.9	21.9	7.1	12.5	11.4	13.2

<sup>1/</sup> Compiled from data in Table 16.



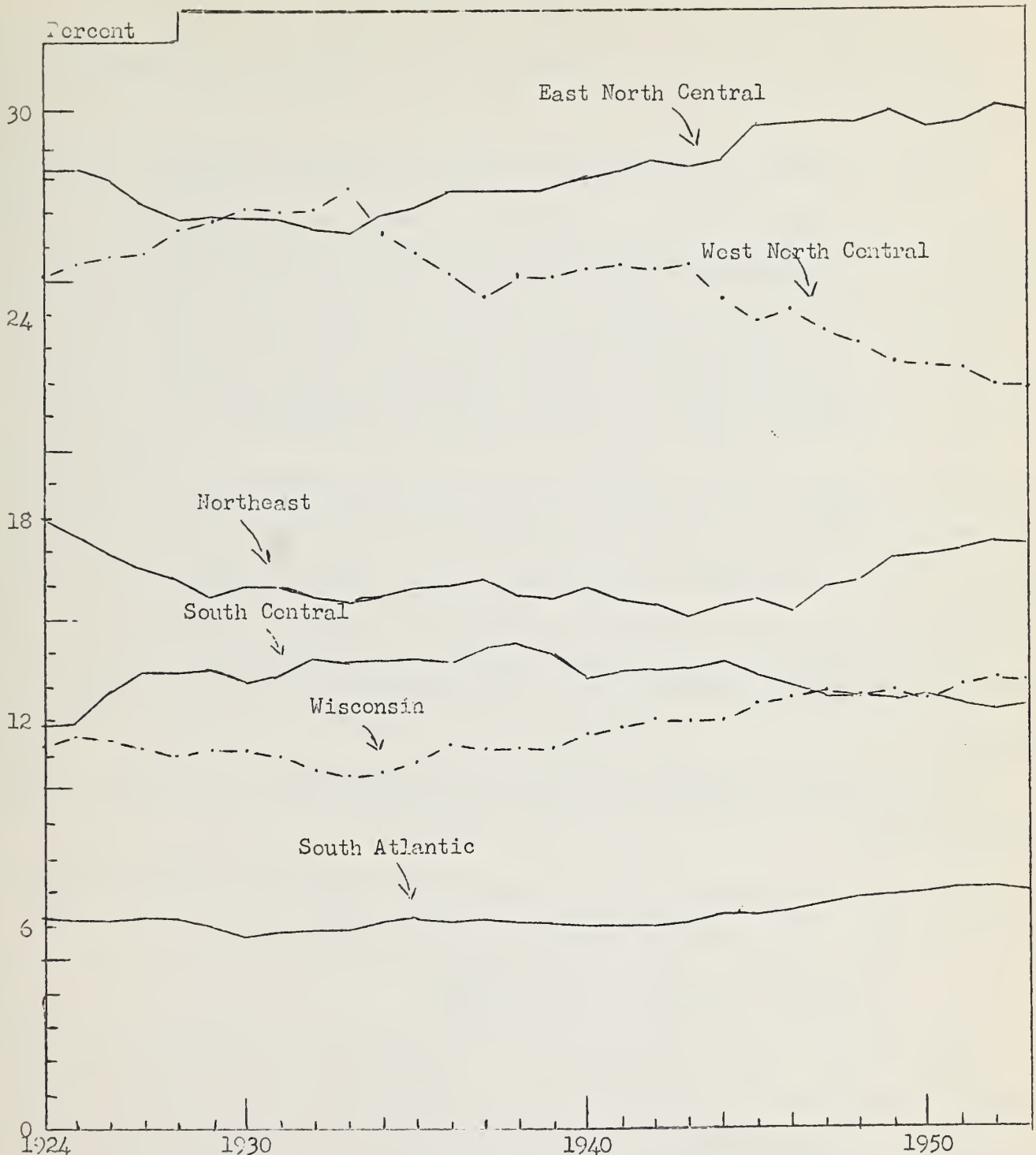


FIGURE 8. PRODUCTION OF MILK ON FARMS IN SELECTED GEOGRAPHIC AREAS, EXPRESSED AS A PERCENTAGE OF TOTAL PRODUCTION - 1924-1953.

The principal producing areas are the East North Central and West North Central States. The former has gained position and the latter lost. The Northeast declined in relative importance from the mid-twenties to the early forties, but regained part of the loss in the last decade. The South Central States gained in the twenties and thirties but lost in the forties. Wisconsin has gained in relative importance.

## PRICING SURPLUS

There was not time for the committee to make an adequate study of surplus pricing.

The main objective in pricing Class I milk is to obtain an adequate supply of milk for the particular market. In striking contrast, the main objective in pricing surplus milk is to price it so that handlers will accept all milk offered by producers at all times. Since the surplus milk has to be utilized in products that must compete in the market place with the same products from other sources, the surplus price has to be kept closely in line with prices of manufactured dairy products.

Two different methods of pricing surplus milk have been used. One is to base the surplus price on the central market prices of the principal products for which the surplus milk is utilized and for which adequate price quotations are available. Another method is to base the surplus price on the prices paid producers for milk by non-regulated plants in the principal producing sections making the same type of products.

Three factors are involved in setting the surplus price on the basis of central market prices:

- (a) The wholesale price or quotation for the particular dairy product.
- (b) Amount of product obtained from 100 pounds of milk.
- (c) Making or manufacturing allowance.

In general, if the surplus price is too low, profits on processing surplus milk are relatively high, and handlers wanting to obtain milk for fluid use have to compete against highly profitable manufacturing operations in order to obtain supplies. This is not conducive to furnishing an adequate supply for the fluid market at moderate prices. On the other hand, if the surplus price is too high there may be some rejection of producers' milk, and it may greatly penalize handlers who specialize in handling surplus, and force some dumping on the fluid market.

It is sometimes contended that the surplus price should be established on a "break even" basis. The processing of surplus milk is an absolutely necessary function that has to be performed in any fluid market. Since it is a necessary function, it would seem that those performing it should be entitled to make some profit.

Under the New York Order, with a more or less uniform method of pricing surplus milk there has been a complete cycle in handling charges. They started out at a low level in 1949, increased in 1950 to 1951, and then declined again to an unusually low level in 1954. Thus, the same pricing system has yielded both high and low handling charges.

In order to appraise surplus prices, consideration has to be given to developments in the market.

#### SUMMARY

There are two different types of Class I price formulas in effect in federal order markets. One is the type where the value of milk for manufacturing purposes is used as a mover for the Class I price. The other type uses various economic factors not directly related to the value of milk for manufacture, such as the general price level, as movers.

After the end of World War II there were marked increases in the margin between Class I prices and the value of milk for manufacture. This increase occurred in all types of markets, federally regulated, state regulated, and also in markets where there was no public agency regulating producer prices. The higher levels of Class I prices have resulted in an increased margin between blend prices and the price of milk for manufacture.

The most important objective in pricing Class I milk is to have an adequate supply for the market. The changes in relationship between the use of milk for the fluid market requirements and of supply are of primary importance in appraising Class I prices. The shifts in the percentage of receipts utilized to supply market requirements is an accurate and sensitive measure which shows whether fluid



requirements are rising or falling in relation to the supply.

For a selected group of federal order markets the fluid market use rose rapidly in relation to market supply during the early forties. In many markets the utilization percentage reached a peak in 1946, and shortages were widespread. From 1946 to 1953 the trend has been in the opposite direction; supplies have increased in relation to market requirements, and the percentage of the supply so utilized declined rapidly. During the period 1947-1953, for a selected group of federal order markets there was no tendency for the Class I premium over the condensery price to be highest when the proportion of the supply utilized for fluid market requirements was the highest.

In some fluid markets it is generally considered that a surplus of 20 percent is necessary in order to adequately serve the market. This percentage of "necessary surplus" no doubt varies from market to market. One way of determining whether or not a market has an excessive supply is to compare the percentage of surplus in the short season with the percentage of "necessary surplus." When the actual surplus is in excess of the "necessary surplus" a market could be considered to have a burdensome or excessive surplus.

The changes in the volume of receipts at the regulated plants under a marketing order are not necessarily a measure of the changes in production by the producers supplying the market. Producers can shift from non-regulated to regulated plants and vice versa, and, in addition, plants may gain access to the market or withdraw. It is difficult to determine the difference in production trends of a group of producers delivering to plants under regulation with the production trend for producers not delivering to regulated plants in the same general geographic area.

In the Northeast, Class I sales in the principal markets rose in relation to total milk production in the area from 1940 to 1946. Since then, production has



risen in relation to the Class I volume. In 1953 the Class I sales were the lowest in relation to production since 1943, but higher than in the early forties (1940-1942). With the increase in milk production in the Northeast in relation to Class I sales, there has been a reduction in western cream receipts at eastern markets.

Over half of the milk produced in the United States is produced in the North Central States. During the last couple of decades the relative importance of the East North Central States has increased, while the West North Central States have decreased. From the mid-twenties to the early forties production in the Northeast did not keep pace with the total production. Since then, it has risen in relation to the total, but has not regained the relative importance held in 1924 and 1925. The South Central States gained in importance from the mid-twenties to the mid-thirties, but this gain has been lost since then.

Relatively little milk is produced in the South Atlantic States, and the relative importance of this area was practically constant from the mid-twenties to the early forties, and since then it has gained from about 6 to 7 percent of the total. The Western States have shown little net change in relative importance. Wisconsin is the leading state in milk production, and the general tendency has been for it to gain in relative importance.

The pricing of surplus milk is probably the most difficult pricing problem encountered in milk price regulation. Since the products made from surplus milk must compete in the market place with similar products made from non-regulated milk, the price of surplus must be kept closely in line with prices of manufactured dairy products. Under federal orders this has been done, in general, by two different methods: (1) basing the price of surplus on the market prices of the principal manufactured products made from surplus milk, and (2) basing the surplus price on the paying price of unregulated plants in important producing areas making the same type of products.

Even the same method of pricing does not yield the same results all the time. In the last analysis, probably the only method of determining whether the surplus price in a market is too high or too low is to watch closely the developments in the market.

II Section On

Movement of Milk and Milk Products Into Markets

A - STATEMENT IN FAVOR OF  
PRESENT ORDER PROVISIONS ON COMPENSATORY PAYMENTS  
AND ASSIGNMENT OF CLASSIFICATION

REPORT OF FEDERAL MILK ORDER STUDY COMMITTEE





October 7, 1954

Section on  
Movement of Fluid Milk and Milk Products into Markets

Statement In Favor of  
Present Order Provisions on Compensatory Payments  
and Assignment of Classification

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Introduction

This is the most controversial subject in the entire field of the Federal milk marketing order programs. It is the principal complaint of critics of the programs in the industry and the Congress.

Therefore, it is of great importance to report adequately to the Department on this subject, particularly by those members of the Committee who feel that the criticisms are unjustifiable.

To make such a report adequate it is necessary to consider the programs not from the standpoint of expediency or statutory authority but from the standpoint of basic economics and sound constitutionality. This really means workability without unfairness to any segment of producers or handlers.

This report is prepared on the assumption that readers already understand the method of pricing milk known as "classified pricing" and the reasons therefor; also that readers understand the need for the government to fix and enforce prices to dairy farmers for milk produced primarily for distribution in fluid form.

It is important to understand these matters because such assumptions are not discussed at length in the following report, but implications from such assumptions are an important part of the bases for the conclusions reached.

An admirable summary of this entire subject will be found in the attached paper of Dr. H. Alan Luke, presented at the Midwestern Milk Marketing Conference at Knoxville, Tenn., April 9, 1954. In Dr. Luke's paper the need for compensatory payments is tied directly to the use of the classified plan of pricing. It is certainly true that without such plan the provisions in question would not be needed.

It seemed more necessary in this report, however, to discuss the nature and development of the geographical and health inspection aspects of milk marketing to show why these have evolved the necessity for the questioned provisions to maintain government classified pricing.

Perhaps exact definition of compensatory payments had best be postponed until the ground work has been laid by the following discussion. As a kind of a sub-title, however, it might not be too confusing to state at this point Luke's summary definition. He says, "They (compensatory payments) are payments which milk distributors must make on the fluid milk they buy from unregulated plants". Assignment of classification provisions are another form of the same thing.

The above introductory statement, with the exception of the foregoing definitions, should be helpful in understanding the following discussion. The definitions, however, should be held in mental reserve until reached in the development of the subject.

## Nature of Regulation

It must be recognized at the outset that any administrative regulation of farm prices for milk by the government is a restriction on free enterprise and unfettered competition; also that a program of regulation necessarily involves rules to govern the extent of the regulation and to make it effective.

## Product Coverage

Starting with the concept or assumption that it is necessary to regulate the farm price for milk produced primarily for fluid use in the major urban markets, the next question is how it should be done.

Should there be one order for the whole United States fixing the minimum farm price in all use classifications for all milk which, either by the existence of official health approvals or by actual marketings, or both, is demonstrated to be a competitive factor in the total potentially available supply for the markets in the United States? Such an order would definitely remove the present criticisms of these so-called barriers.

However, a nationwide order has not been used for this purpose or even seriously considered for so many obvious reasons that it seems sufficient to say that the programs must be operated, if at all, on a somewhat smaller than national coverage.

## Extent of Coverage - Generally

Thus, it is clear that a definition of the scope of each regulation is essential. The regulation is the fixing of a price. It must be the price of something. What is the thing to which the regulation is to be applied? In the case of milk orders as now used, the thing, the price of which is to be regulated, is milk suitable and available for consumption in fluid form.

But the United States is full of such milk. With anything smaller than a national order it becomes necessary to say which milk, suitable and available for fluid consumption, is to be regulated, by each respective order.

#### Limitations of Coverage

To limit the scope of the regulations to something less than national coverage, some rule or definition of the extent of the coverage must be devised. It might be that the United States could be divided into several production districts covering the entire country, something like Federal reserve districts. But this does not make sense from an economic standpoint. Any such districting would result in defining districts which, in practically all instances, would fail to conform to actual marketing practices, or constitute proper supply areas for particular markets.

Furthermore, these regulations inherently are restrictions on free competition. In regulating competition and operating such regulation through many separate and distinct but operationally similar programs, an attempt should be made to include to the greatest extent the major competitive elements. At the same time, the regulation of supplies which are competitive only to a minor extent should be minimized. This is particularly true where the competition is minor from a frequency standpoint.

Regulation confined within the boundaries of production districts would regulate either too little or too much milk. If the district were deficient in production with relation to consumption then some of the necessary supply would be regulated by possibly conflicting regulation of another district. If the district had a surplus of production over consumption, then there would be unneeded regulation of more than the necessary supply. This might conflict with regulation of the supply of some other district which needed the supply from the district with extra production.



Thus, as regulation on either a national or multiple production district basis has seemed inadvisable, some other method had to be employed to define the scope of each order program. This has been done by facing up to the true aspect of the project as being a regulation of competition -- not a regulation of people, states, districts, land areas or commodity origins.

Competition can be regulated by markets, so this is the approach that has been used in the orders. First, the market has to be defined and then its sources of supply regulated.

#### Types of Regulation - Generally

To show what rules have to be adopted for the purpose of carrying out the above general conclusion as to method of regulation, it is necessary to consider the methods which have to be applied in pricing milk at the farm level.

Historically two methods have been found feasible. One is the "handler pool" method and the other is the "market pool" method.

In the handler pool orders the producer is paid a blended price based upon the uses of only the one handler who receives his milk. In the market pool orders the producer is paid a blended price based upon the uses of all handlers for the market.

#### Coverage in Handler Pool Orders

In the handler pool orders the milk is priced for each handler separately. What is priced is all the milk handled by each individual handler in and for the market. This coverage is not hard to determine under simple rules of identification. Generally in such orders the coverage as to each handler is simply defined as all the milk received by the handler from producers at the city and/or country plants run by such handler in and/or for the market.

Such a handler will not buy extra milk beyond his requirements as it will decrease his blended producer price and jeopardize the continuance of the patronage of his producers.

In some of these handler pool orders the coverage determination is a little more complicated by provisions based on administrative expediency. Under such provisions the plant shipping the extra milk does not have its milk priced but the handler's main supply is given priority rights of classification in the handler's higher priced uses under the classified price plan. Then the outside milk is assigned to and priced at the lower return uses. This, however, is not an important target of the criticisms being discussed. This type of assignment of classification is merely an administrative convenience. It is no more of a so-called barrier than would result from pricing all receipts, as first above described. True, handlers will limit their receipts to avoid diluting their individual blended prices which they pay to producers. This action is necessary to maintain producer relations and patronage. It also effectively limits ability of other possible shippers to enter the market.

A handler pool order will not work unless it is applied to a deficit market without sufficient production to supply the demand or unless nearby market pool orders soak up any potentially competitive surpluses. Unless there is a deficit condition or a nearby sponge operation, the handler pool orders will not work because unequal distribution of surplus among several handlers will result in widely varying prices to producers. Even in deficit markets, the dealer pool type of order may not work if such small surpluses as unavoidably exist, are unevenly held by various handlers causing some

variation in producer prices. The reason why such an order will not work is because it does not provide for market-wide equalization. Without equalization, it will be upset by irresistible economic incentive for handlers and producers to compete for higher priced outlets.

In any event, the great bulk by volume and number of all the orders are market pool orders and the weight of the criticism of compensatory payments and assignment of classification provisions falls on the market pool orders for reasons that will appear later.

#### Coverage in Market Pool Orders - Need for Rules

As previously stated, the distinguishing feature of a market pool order as compared with a handler pool order is that in a market pool order all the milk of all handlers is pooled or equalized. This means taking money through operation of the equalization pool from groups of producers delivering to handlers with higher priced utilizations and giving it to other groups of producers delivering to other handlers with lower priced utilizations.

Why not use handler pool orders instead of market pool orders and thereby avoid this attack on the compensatory payment and assignment of classification provisions that are essential in the market pool orders, as will be explained later?

Market pooling plans have been found necessary over many generations in most major markets in many countries. At first these programs were operated by co-operative contracts between producers and handlers. Later government enforcement power was added to stabilize non-cooperating producers and handlers.

Market pooling was found essential to equalize the burdens of the surplus and the benefits of the higher priced fluid sales among all the market producers. Such equalization was specially needed in large, highly organized

markets where efficient specialization in handling and multiplicity and diversity of ownership and interest among handlers results in individual handlers more efficiently operating in either lower and higher priced utilization positions. Thus, unless all producers share both ways through equalization, the economically irresistible financial incentives of the lower return producers and handlers will surely break the stabilization structure. This will come about either by mass pressure of opinion or actual forcing of higher class sales through evasions of the regulation.

After the establishment of this assumption of essentiality of market pooling in many major markets, the next question is why compensatory payments and assignment of classification provisions are considered to be needed in such programs. To understand this it is necessary to explain the problems with relation to coverage or incidence of a market pool order.

In the first place, it becomes administratively essential to identify the thing, i.e., the milk, to be priced; in other words, to define the coverage of the regulation.

Secondly, it is readily apparent that manufacturers whose sales receipts necessitate a lower rate of return to producers will unavoidably be attracted to get under the market pool orders for the purpose of collecting equalization and raising their payments to producers but serving the fluid market as little as possible.

Thirdly, under a market pool order every farmer's milk is directly affected by all the milk of each and every other farmer in the equalization pool. Total values amount to huge sums -- as much as a million dollars a day under the New York order alone. Such a program must have hard and fast rules



to be enforceable. Large equalization payments cannot change hands on a loosely drawn regulation.

### Types of Supplies

Markets are supplied with milk delivered in two ways. In the smaller markets much of the milk is hauled to market direct from dairy farms in farmers' cans. Some, more recently, is picked up by tank trucks from tanks installed on farms. Extra milk needs, beyond such direct delivery, are supplied by bulk shipments from country receiving and shipping plants. In the larger markets, the great majority of the supply is obtained by the latter method.

In designing a regulation, the administrative question immediately arises of determining what supplies are to be covered by the regulation. In discussing this question many qualitative words are often used, such as "regular", "tributary", "normal", "natural", "nearby", "convenient", "necessary", "reserve", "emergency", "adequate", "dependable", "casual", "incidental", "occasional", "primary", etc. It is doubted whether, legally, any regulation under a market pool milk order can effectively be enforced if applied by administrative discretion broadly delegated by any such qualitative words. Definition of coverage must be by rules which implement the concepts inherent in some of these descriptive words, but there must be some definite objective tests on which to bring an enforcement case in event of violation.

Several methods have been tried to define the coverage of these regulations.

## Early Simple Methods

### (a) Identification by Delivery

The method which may appear the simplest is to price and pool all the milk received at any plant from which milk is distributed in the market in the form of fluid milk during a particular delivery period; generally one month. This method is open to serious objections, however, particularly in application to the larger markets.

The rule would price and pool all the milk in any plant from which any milk was distributed in the market as fluid milk -- including "bootleg" milk. In effect, it would ignore health approval as a standard; or, assuming complete enforcement by the health authority, this rule would be subject to certain other objections which are also pertinent to the next rule herein and will be stated in discussion thereof. This rule would make no provision for inclusion of "reserve plants" which are necessary to maintain a dependable and continuous supply, if they distributed no milk in the marketing area during a particular delivery period. On the other hand, a mere "token" shipment would qualify what is in reality a manufacturing plant to collect equalization payments on large quantities of milk manufactured.

Another objection to this simple rule is that in the larger markets it would militate against the efficiency of continuous manufacture of necessary reserve supplies. Plants would have to interrupt such operations to ship fluid milk to get pool plant identification and thereby insure coverage by the order.

(b) Identification by Health Approval

Another version of this early simple method of determining market order coverage was to price and pool all milk delivered at plants approved by the health authority having sanitary jurisdiction for the market as sources of supply for bottling quality milk.

The first objection to this rule of identification brings in a fact which importantly permeates the entire consideration of this matter. It is that there is another governmental agency, completely separate and distinct from the federal Department of Agriculture, that has a lot to say about what milk may be used for drinking purposes in a market. Such agency is the health authority having jurisdiction to prescribe and enforce the sanitary regulations for the milk supplied to the market.

Such authorities are, or should be, concerned solely with sanitation and not with economics; but, if these simple rules are used to determine pool coverage, then all sorts of questions arise as a result of the reciprocal impact of the economic (price order) regulation and the regulation activities of the health authorities.

A health authority may decide to withdraw inspection from certain sources which it may deem, correctly or incorrectly, are not needed from either a short or longer time viewpoint. Assuming, for the sake of discussion, that such determination is erroneous; then the excluded sources, both producers and handlers, are deprived of benefits of regulation, at least until short or long seasonal or cyclical changes again bring about market need for their milk. Without any criticism whatever of such determinations of the sanitarians in these matters and assuming they never wish to manipulate the economics of the milk order regulation, nevertheless, it is readily apparent that they should not be

saddled with the burden of regulating the financial livelihood of a lot of dairy farmers on a matter of pure economics. They should be left unfettered to pursue their very necessary inspection and approval activities without regard to the economics involved.

On the other hand, the action of a health authority might have the effect of enlarging the regulated supply. For example, there could develop tremendous economic pressure to approve an extra supply of borderline sanitary qualification merely for the purpose of bringing it under the pool to collect equalization even though it might turn out that all of such supply was manufactured into products not requiring approval. The incentive to collect equalization payments from the pool amounts to something like a dollar a hundredweight. This could multiply into large sums for a plant operator. Such a situation creates pressures. Whether or not such pressures are applied or effective, this example illustrates the fallacy of delegating economic authority to an agency which should be concerned only with health and sanitary standards.

Another objection to simple board of health rule of incidence of a market pool is that many health authorities do not have adequate records well organized for ready reference in the exact detail needed for quick month by month computation of the blend prices payable to producers. Handlers may also obtain health approval with no intention of supplying milk to the market, but merely because they might wish to do so at some future time. The existence of health approval for a particular supply of milk is not evidence, in itself, that such milk is intended or available as a part of the supply for the market. The intention may be merely to "ride the pool" as it is called in the industry by collecting equalization payments on an operation intentionally restricted to manufacturing at lower price returns.



There are additional objections to tying pool plant identification rules too closely into health authority approval or to month to month fluid shipment or a combination of these two.

One objection is that health jurisdiction in some present instances is not tied to a particular market -- sometimes it is state inspection approving milk for various markets within the state which are unrelated from an economic price regulation standpoint. This is not only a present actuality but may increase with changes in laws, interpretations of laws, arrangements for reciprocal exchanges of inspections between states and between markets within states and increasing acceptance of United States Public Health Service certification. Under these circumstances, health approval as a means of pool identification is not feasible in some instances and is of very questionable workability in others, principally because it is not geared to particular market needs.

Another objection is that a plant may accidentally get into the pool even though it does not desire to be associated with or service the market. One small fluid shipment, perhaps arranged by intervening brokers, under a "sleeper" or "hang-over" long unused health approval, a state-wide approval, reciprocal approval, a U. S. P. H. approval or a shipment by mistake without approval might result in the regulation being applied to the operator of a large volume plant who did not want any such order coverage.

#### Fall Shipment Rule

To meet the objections to the rules just discussed many orders in identifying plants for order coverage use a qualified shipment or performance rule. It conditions full pool plant status (all receipts priced and equalized) on shipping performance in the preceding short (fall) period.

This is often a condition prerequisite to full pool status in the spring flush months. It requires a certain percentage of market shipments in the short months as a condition to full pooling of the plant in the spring when, because of lack of market need, the plant may be manufacturing and collecting pool equalization payments as a necessary reserve supply. Such a rule may provide for full pool participation in other than spring and fall months if the plant meets certain minimum percentage shipping requirements month by month.

#### Designation Rule

Some orders add a provision for administrative convenience whereby certain fully approved or approvable plants located within the long established general historical boundaries of the milk shed (supply area) are given full pool status by designation based on specific criteria. Sometimes there is added a condition of readiness and willingness to ship when needed. This must be shown objectively by freedom from contrary commitments and subjectively by actually so shipping on call to supply any market shortages.

#### Combination Rules

Many orders combine parts of all or several of the above rules to provide identification for pooling and pricing purposes so as to avoid the objections to any one of the several rules as applied to individual market problems.

#### Necessity for Compensatory Payment and Assignment of Classification Provisions in Market Pool Orders

In adopting fall shipment and other combination rules to meet the serious objections to the month by month shipment and board of health rules, certain types of pricing problems have in turn been created. These have been met by certain types of pricing provisions applicable to milk which may come into the market from plant sources not meeting the qualifications for full pricing and pooling of their entire receipts.

These problems arise because it is inherent in the more refined full shipment performance and combination rules that some plants may not meet the pooling requirements but, nevertheless, may be able to ship milk into the market in full compliance with the sanitary regulations. Thus, if such milk is not priced in some manner it may be available on a "least-loss" or "opportunity cost" cut-price basis. This milk will then operate to disrupt the market because of lack of uniform product cost to competing handlers. More than that, it will replace the milk of fully priced and pooled producers and plants in the higher priced uses.

The classified price plan cannot continue to operate in the face of such competition. Such plan, with its higher price for fluid use, 1/ makes the market attractive occasionally to the outside shipper.

At this point, it may facilitate analysis of the problem to reiterate the facts previously developed and emphasize the absolute conclusion therefrom; viz., that the failure of any plant to meet the full pricing and pooling requirements of such an order is solely because of its choice of marketing operations and not because of any arbitrary or capricious selection by the regulatory authority.

Nor is it because of its location, except to the small extent that nearby plants are given permanent designation to facilitate efficiency of administration. While this designation of nearby plants may be criticized as being merely geographical selectivity, any such argument is fully met by the fact that any plant anywhere may become fully priced and pooled by meeting the operational shipping requirements.

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1/ This is the incentive necessary to induce producers to meet more costly board of health production conditions.

Some means is essential to identify the milk which is to be fully subject to the regulation. At the same time it is necessary to avoid extending regulation to supplies of milk which have only incidental, or sometimes accidental, relation to the market. It follows that some milk may actually be available in the market from sources not fully subject to the regulation. Some method must then be developed to insure that the milk from sources not otherwise regulated does not enjoy a competitive advantage over the milk that is fully priced and regulated under the order.

### Compensatory Payments

Some very important market pool orders contain provisions for pricing milk shipped into their markets from plants which have not so operated as to meet the requirements for fully priced and pooled plants.

This is done by providing for a compensatory payment to the pool by the receiving handler of an amount fixed by certain rules as nearly as possible to bring his raw material product cost up to that of competing handlers getting their milk from fully priced and pooled sources.

(The establishment of this rate is admittedly a difficult matter. Generally speaking, it is fixed at the difference between the opportunity cost, i.e., probable return from other available outlets, and the full price. It is believed that the cooperative and proprietary proponents of these rules and the Department have arrived at fair and administrable formulas for the fixing of such rates. The most recent and comprehensive considerations of this matter are in the St. Louis and New York final decisions on amendments to such orders on this point. Perhaps more experience will indicate possibility of improvement. The matter is always open for reconsideration in the light of experience and



new thinking. However, this is not the main question. The main question is whether there should be any such payment. This main question must not be lost sight of in the discussion of this detail. The main question is one of principle, not measure.)

These payments are needed to insure uniform product cost between competing handlers. Thus they prevent the regulation from creating unfair competition between competing handlers because of unequal product costs. They are also necessary to compensate producers whose milk is fully priced and pooled from lower prices because the milk from non-pool, unregulated sources has forced a like amount of their milk down into lower price return utilizations.

These payments are automatically suspended during market shortages and may be reduced during partial shortages. Thus, when the payments are in effect, there is no question of the damaging effect upon producers whose milk is fully priced and pooled, because at such times they have milk available for the higher class uses which is forced down into lower classes by the receipts of outside milk.

The ultimate reason, derived from the above premises, for these payments is that the market pool orders with classified price plans cannot be continued without them. Experience under the market pool order programs has led conclusively to forms of open, non-exclusive, operational methods of pool identification, as being the only fair and workable manner of designing the regulations. Then the adoption of such method of pool plant identification has just as conclusively led to these payments as the only means of sustaining the programs on a basis of equal competitive opportunity to all handlers and producers.

### Assignment of Classification

Two U. S. Courts of Appeals have seemed to distinguish between assignment of classification provisions and compensatory payments, under the present Act. However, the adverse decision on compensatory payments in the Babylon (Kass) case by the Second Circuit is not too clear and was made on a hearing record, findings and conclusions, decision and order provisions which have since been completely re-heard, re-decided and re-amended.

In any event, the purpose of this discussion is to show that these provisions are fair, reasonable, necessary and proper, rather than to discuss fine points of statutory construction.

From an economic standpoint and from the standpoint of fairness, there is no substantial distinction between compensatory payments and assignments of classification provisions. Considered on dollars and cents basis they are practically the same.

The assignment of classification provision means simply that if a handler gets milk from a source not fully priced and pooled he assigns it to his lower return utilization, generally Class II, so as to give the order milk priority in his higher return utilization, generally Class I. Thus, he pays into the pool on the non-order milk the difference between the two class prices, which figures out about the same as the compensatory payments in other orders.

The principal reason for the use of the compensatory payment instead of the assignment of classification provision in certain orders is that if a receiving handler has no milk in Class II, the assignment of classification provision is obviously ineffectual and the handler gets a product cost advantage over a handler using only fully priced and pooled milk.

There are also some administrative difficulties in such assignment even when the receiving handler has Class III use of fully priced and pooled milk. Such difficulty arises if he receives the outside milk in the form of cream. In such case the classification of the milk used to make the cream has already been established in Class II by necessary administrative rules. Thus, there is an administrative difficulty in re-classifying.

All the reasons justifying the compensatory payment provision are pertinent to the assignment provision, since they amount to the same thing economically.

### Consumer Protection

There is an underlying assumption in the foregoing discussion that these market pool orders with all the provisions necessary to make them workable are essential to stabilize prices to producers against disruption resulting from disorderly marketing. This is in accordance with the stated policy of the Agricultural Marketing Agreement Act, and is in the interest of all citizens including consumers. However, there is a more definite and direct benefit to consumers. That is the assurance of an adequate, available and reliable milk supply for the consumers of each market.

It has been shown that market pool order regulation is the only effective and feasible form of regulation in the principal markets and that compensatory payment provisions are essential to the maintenance and operation of such pools. Therefore, any abolition of compensatory payments means the end of regulation in such markets.

The end of regulation in such markets means that the maintenance of the local milk supply is seriously jeopardized because unregulated competition will force prices down to the price of milk for manufacture. This will greatly

reduce local production, but more distant producers and handlers will not ship to the market because they will gain more by manufacturing than by paying long distance hauling on milk to be sold at destination at manufacturing milk prices.

On a national basis the removal of the market pool orders would soon result in such shrinkage of local fluid market supplies that the total supply would be shortened to a point where major fluid markets would bid up the prices of more distant milk. Then the consumers would pay more for non-locally inspected milk long hauled from far distances with possibly resultant quality defects. That is, they would pay more than if they had been allowed to pay for and keep their long established regular supplies.

Thus, even from a local consumers' price, quality and availability standpoint, the programs should be maintained.

There is one other consumer price argument which is not properly a part of this section of the committee report but which probably should be mentioned here for the sake of completeness.

It is that the compensatory payments and more particularly the pool plant designation provisions to which they are a necessary corollary, protect the market so that the Class I prices for milk for fluid consumption can be and are fixed too high.

This is a matter of basic pricing policy and philosophy for other sections of this committee. However, it seems well to note here, at least for cross-reference, that the northeastern orders and some others have Class I price formula provisions reducing the prices when production increases relative to demand and the other orders base their Class I prices directly on manufacturing milk values with a differential for meeting health requirements for approval for fluid sale. These methods afford adequate consumer price protection.



Whether these formulas are properly adjusted is a matter of degree and not of the principle here being discussed.

As a footnote to this point it is a matter of interest that the critics are not consumers but free-lance, outside, non-pool shippers. Furthermore, as above demonstrated, if they break down these regulations, they will not want the markets because the price less the extra hauling will be too low.

#### History of Such Provisions

There seems to be some prevalence to the idea that these provisions are recently invented gadgets; devised or instigated for the sake of more and better complicated gadgetry.

On the merits, the position has already been stated.

On the history, versions of these provisions trace back through many years of market orders, at least to 1941. It would be strange, indeed, if some progress had not been made in administrative techniques during that time.

#### History and Origin of Criticisms

This subject always comes up in the cycles when there is too much milk around. The free-lance shippers both within milk sheds and more remotely located are happy when milk is short, manufacturing milk prices are up in relation to Class I prices and they can get the real high dollar supplying fluid milk to deficit markets. Then when there is a national surplus and manufacturing milk prices get low compared to Class I prices they want "in" all the organized markets without associating themselves in a business way with any one.

Before World War II only twenty-nine percent of the milk drawn from cows in the United States was moved off the farm in commercial channels as whole milk. Then during the war there was a tremendous conversion. We now have

sixty-nine percent delivered in the form of whole milk. Also there was a considerable conversion, even within the deliveries of whole milk, to production meeting Board of Health conditions, of milk which had theretofore been of only manufacturing quality. There was also a conversion of receiving plants to Board of Health approved shipping plants and very substantial investments by proprietary owners and farmer members of co-operatives in such "war baby" operations. During the extremely high demand, because of greater consumption by the Armed Forces and the general public on account of shortages of other foods, these "war baby" operations selling milk for human consumption were highly profitable both from an operating standpoint and from the standpoint of the level of the farmers' milk checks. It is perfectly natural now that this wartime bubble has burst for those who promoted the farmers to switch to whole milk delivery and Board of Health conditions and those who promoted proprietary owners and farmer members of co-operatives to invest in expensive Board of Health plant facilities, to seek a goat to blame. These shippers think they acquired a quick and easy vested interest in fluid outlets during wartimes. The handy goat on which to blame the loss of their participation in fluid outlets is the government agency administering the regulation in the fluid markets, along with the producer and distributor organizations that supply such markets.

There is one other important point which should be made under this heading and that is that various distributors from time to time toy with and occasionally act on the idea of breaking down any and all impediments to the absolutely free flow of milk between all areas. Scrupulous distributors when they give this matter sufficient analysis will not engage in such tactics because of the

inherent threat to all milk supplies through instability and disorderly marketing resulting from the removal of price regulations. However, it is a long-established principle of the distribution business to buy as cheaply as possible.

#### Other Possible Remedy

As a matter of general policy the main committee has sought administrative rather than legislative remedies for problems in the order programs.

It is interesting to consider, however, whether the Act could be amended to allow the pricing in market pool orders but on a dealer pool basis of all of the receipts, whenever milk is shipped to a market pool order market, by a handler not fully priced and pooled under the order. It would be difficult for him to argue that his milk should not all be priced inasmuch as he now seems to be objecting that only a part of his milk is priced. He might argue that he should be fully equalized like the regular market handlers. The answer to this is that he presently can be fully pooled if he picks his market and serves it on a substantially continuous basis. If he argues for pooling without firm association with the market and the operational service requirements with respect to it, he is simply saying he wants to "ride" the pool.

Such a statutory amendment and order provisions thereunder would stop the criticism that these payments are a tax, penalty, barrier, assessment or import duty. However, it certainly would not meet the demands of free-lance shippers for unregulated entry into any and all market pool regulated markets, which is the very apparent object of the present criticisms.

Therefore, such a legislative amendment project would seem inadvisable.

### Conclusion

The burden is on the critics to prove that the market pool orders will work without these rules for compensatory payments and assignment of classification. Either that or they must prove that there should be no orders. They have not and cannot sustain this burden.

As a matter of good conduct people should not indulge in the cliché that "Federal orders are all right but that barrier gadget ought to be removed" unless they can prove the orders will work without it or unless they propose a definite, workable, substitute.



UNITED STATES DEPARTMENT OF AGRICULTURE  
Agricultural Marketing Service

DEVELOPMENT OF COMPENSATORY PAYMENTS  
IN FLUID MILK MARKETS

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(Paper presented by H. Alan Luke at the Midwestern Milk Marketing Conference, Knoxville, Tennessee, April 9, 1954)

Many of the Federal milk marketing orders contain provisions requiring payments on unregulated milk, or compensatory payments, as they have come to be known. The nature of such payments is generally understood. They are payments which regulated milk distributors must make on the fluid milk they buy from unregulated plants.

The reasons for such payments are not well understood. It is appropriate, therefore, that a conference such as this should give consideration to the basis for compensatory payments and to the problems they involve.

A better understanding of compensatory payments should do two important things. It should help the industry people affected to adapt their operations with a full knowledge of the purposes and effects of the provision. It should contribute also to improvements in the order provisions themselves, in line with the standards of orderly marketing and adequate milk supply as contained in the Marketing Agreement Act.

In recent months, a great deal of attention has been focused on compensatory payments. This is the result in large measure of changes in the pattern of milk marketing which have developed rapidly over the past few years. These changes have been of such a nature that they have increased the need for and the use of compensatory payments.

Since our experience with such payments is as yet rather limited, it is likely that they can be adjusted or improved as time passes. Such adjustments may be needed to facilitate the efficient and orderly movement of milk from producers to consumers. It may be that a different and better method of regulation may be devised in the future which will accomplish the purpose of compensatory payments and which will be more widely understood by those affected.

Some questions have been raised concerning the use of compensatory payments under Federal orders. Opposition to such payments has been based largely, I believe, on a misunderstanding of both their purpose and their overall effect. It has been asserted that these payments are penalties, special excise taxes on milk from outside sources, or trade barriers by which a given milk market may be reserved for a particular group of producers. An easy, but incorrect, explanation of the payments is that they are a means whereby the fluid milk price may be protected at an abnormally high level in that they discourage importation of outside milk through the assessment of an additional payment on such milk.

Compensatory payments unquestionably do discourage some transactions which might otherwise be encouraged in markets where classified pricing programs are in operation. Plant operators who have offered bulk milk for sale in a regulated market may have been refused sale in some instances at the going price for such milk because compensatory payments would be required on such milk. These people may have difficulty in believing that there is not an element of trade barrier in such payments. Compensatory payments as used under the order program are barriers, however, only to the extent, and no more, than the classified pricing system itself is a barrier to free trade in market milk.

Classified pricing systems for milk are well understood and widely accepted in older milksheds. They may not be as fully accepted and certainly are not as well understood in some of the newer areas of Grade A milk supply.

Classified pricing systems are now used almost universally in the larger milk markets of the country. They were developed, for the most part, at a time when milksheds were more or less confined to those farms which were under rigid inspection of the health authority having jurisdiction over the local market. Such inspection was necessary because of the inadequacy of other methods of assuring the safety of the milk supply. Under such systems, the classified pricing program was subject to far less pressure than it is today. Even so, these classification plans developed, as a rule, only after years of turbulence and, in some instances, chaos in the market.

The two basic conditions which brought about classified pricing systems were the inability to adjust milk production so that it just equalled demand on a day-to-day basis, and the need for a premium over ungraded milk prices to sustain production of the quality milk required for fluid use. The reasons for the existence of excess or surplus milk above Class I needs in a fluid milk market, such as perishability of the product, fluctuations in production and consumption, and so on, are well known to this group.

The need for some premium over ungraded milk prices to obtain Grade A production has been established on the basis of many years' experience throughout the country. If the production of satisfactory milk to be used for fluid consumption is to be maintained, the price received for such milk must be somewhat above the rate of return obtained from milk used in manufacture. This extra money can come only from the milk actually used for fluid consumption. As a matter of fact, this is the place it should come from, since consumers of fluid milk should pay the costs necessary to give the assurance of supplies of such milk as they demand. Milk disposed of as excess cannot yield an extra return. If it is to be marketed at all, it must move into manufactured products. If it is run down the drain, as is now the case in isolated instances, it would yield no return at all, and the price for fluid milk would have to be raised that much higher to maintain the necessary levels of milk production.



This excess milk is an essential part of the market supply, however, and it must be disposed of in some manner. In an unregulated or unorganized market, the owner of such milk will normally try to sell it to his best financial advantage. Disposition of a portion of milk to fluid-milk outlets, and the remainder to manufactured-product outlets, will naturally yield a blended return. How much this return will be above the manufacturing value depends upon the proportion of milk sold for fluid uses.

In such a market, there is no limitation on how Grade A milk may be marketed. The distributor who can sell the largest share of his milk in the fluid market will naturally be in the best position because his net returns from the sale of milk will be above that of his competitors. Since milk dealers are in business to obtain the best possible profit, they would naturally make an effort to gain the largest possible share of the fluid market. Such competition may well lead to concessions in the fluid milk price, first by one dealer and then by another. The only floor or bottom to this price cutting may be the value of the milk for manufacture. This price-cutting force tends to be strongest, and the potential losses or gains to dealers greatest, during the spring months or other periods of flush production.

Individual dealers are not in a position to hold the line against such price cutting. No distributor could long afford to pay a premium price for the milk he used for fluid sales and sell in competition with others who are buying such milk at manufacturing prices.

Producers in the older market supply areas have seen this process develop. In some instances, they themselves suffered most of the consequences. Handlers who were unwilling to receive enough reserve milk to sustain their own operations on a year-round basis sometimes attempted to solve their problems by cutting off producers. In this way, a handler could pay producers at a blend price and sell all his milk for Class I use. Producers cut off in this process were ordinarily forced to sell to manufacturing plants or make their milk available to other fluid distributors at reduced prices.

The end of such price cutting among producers, like that among handlers, may well be the manufactured milk price. In both instances, the competitive process destroys any price differential for Grade A milk production. Without a stable and dependable incentive for production of fluid milk supplies, the position of distributors and consumers, as well as the position of producers, would be seriously jeopardized.

As a result of the experiences under such competitive conditions, producers supplying most large markets realized that it was in their best interest, as well as the interest of distributors and the market as a whole, to institute a classified price plan for the entire market. All distributors would thereby pay a full Class I price for any milk for fluid use, and each producer would be paid for his proportionate share of the excess milk of his distributor or of the market.

In a large number of instances it was necessary to resort to some governmental authority to require that each dealer pay the price for fluid milk which was necessary to stimulate adequate production of Grade A milk over a period of time. The competitive position of all dealers who abided by a classified pricing program would be assured under this program.

By and large, classified pricing has proved satisfactory to producers and to the markets where they have been used. There is comparatively little indication that individual producers supplying regulated markets at the present time attempt to gain a disproportionate share of the Class I milk sales. In my judgment, this may be attributed to a general realization that classified pricing is essential, and to make it work, each individual must accept a lower return on a fair share of his milk.

Whereas the problems of supplies and prices in the earlier days of the order program were confined largely to the local milkshed area, the problems are now much more widespread and difficult. Improved trucks and roads, coupled with the increased interchangeability of inspected milk and other factors, have greatly extended the potential supply and distribution area. The first classified pricing programs had the problem of controlling a market in terms of its nearby and locally inspected milk. The primary purpose of these programs was to keep the market's own excess supplies from entering into competition on the fluid milk market and destroying the Class I price structure.

With the increased movability of milk and its interchangeability, it is now necessary to take into consideration the inter-relationship of supplies and distribution in not only the market itself, but in other markets, some of them far distant.

Obviously, it would be impossible to protect the Class I utilization of a market from demoralization by use of its own excess or reserve milk and, at the same time, allow such milk to be sold without regulation from another market. It is not difficult to visualize the quick end which would be brought to classified pricing programs in neighboring cities if they were able to unload their surpluses on each others' Class I markets without limitation of any kind.

Compensatory payments have no other purpose under the order program than to insure the effectiveness of a classified pricing program. Congress has authorized milk to be classified and priced in accordance with its utilization. This cannot be done on a selective basis. Part of the milk entering a market cannot continue to be regulated and subject to classified prices if another part of it can enter freely, without price fixing of any kind, and displace priced milk whenever it is advantageous to do so. Some provision to prevent this seems to be not only incidental but absolutely necessary to permit a classified pricing program to be effective.



Under the order program, the regular sources of milk for a market are brought under regulation and pricing. The orders do not say who or where these sources shall be. Any plant or any producer may qualify as a regular source, as far as the orders are concerned, by making milk available in accordance with the terms of the order.

In order for the milk to be considered available, it must meet the standards of the appropriate health department. Also, producers delivering their milk to plants located at a distance from the market must expect less for their milk because of transportation costs. These two limitations are not imposed by the order program but must be recognized in drafting order regulations. Aside from these provisions, however, orders should provide equal treatment for any plant or producer, regardless of location.

If it is agreed that a classified price plan is necessary, and that it should be maintained in a market by guarding against encroachments on the Class I market by its own excess milk or by that from other markets, then the next question to be answered is whether compensatory payments are the best means for assuring such protection. Perhaps the best way to approach this question is to consider the alternatives. The first alternative which might be considered would be to prohibit the sale of any milk except that from regular sources priced under the order. The act does not grant authority, however, for such a limitation. Nor would a regulation of this kind be desirable. If the milk is acceptable to the health authorities of a market, the order program should not prevent its sale.

A second alternative would be to fix milk prices in all plants which supply milk to either consumers or distributors in the regulated marketing area. This may have disadvantages both in the plants supplying the milk and to the market. It would greatly expand regulation, since any plant which supplied any quantity of milk to the market would be brought fully under the order. The market might have difficulty obtaining supplemental milk if plants which could otherwise furnish needed supplemental milk preferred not to come under regulation. Such a method would also open up a marketwide pool to any plants or producers that found it advantageous to share in the Class I sales of the market on an opportunity basis. It would be necessary only to supply a token quantity of milk to plants or consumers in the market. Under the present provisions of the act, all plants whose milk prices are fixed must be included in the marketwide pool. Unlimited participation in the marketwide pool would permit surpluses from other markets to be shifted to the regulated market. Such widespread distribution of pool funds to persons not associated with the market would divert the returns from the fluid milk sales away from their purpose of encouraging the production of a dependable supply of quality milk. Thus, the effectiveness of a marketwide pool in providing orderly marketing and adequate milk supplies would be destroyed. No program of regulation with a marketwide pool could be successful under these conditions.

If neither of these alternatives can be used, then it is clear that there may be some unpriced or unregulated milk available for sale in the market. If this milk is available to distributors at a cost less than that

for Class I milk priced under the order, then there will be an incentive to buy the unregulated milk. If any distributor buys such lower-cost milk, his competitors will be at a disadvantage if they do not do likewise. Such a situation would naturally threaten the stability of any classified price program and has, in the past, resulted in producers being cut off the market. This situation is identical, in fact, to that previously discussed, which necessitated the institution of compulsory classified pricing in the first place.

The method which has been adopted under the Federal order program to avoid such market instability is to require a payment on unregulated milk used for fluid distribution. There appears to be no suitable alternative method under the present authority of the act. The rate of payment should be one that will assure that regulated distributors may not secure unregulated milk at a cost advantage over regulated milk. If milk purchased from outside sources for fluid use costs handlers as much as milk purchased under the order, then the objective of compensatory payments has been achieved. It is not an objective of these payments to secure money to be distributed to producers under the order.

That, in a few words, represents, as I see it, the basis and justification for compensatory payments. It might be well, however, to address a few remarks at this point to some of the problems encountered in determining the rate of payments to be used.

I have said that the purpose of compensatory payments is to bring the cost of other-source, or unregulated, milk up to the cost of milk priced under the order. It has been suggested that this might be accomplished by having the market administrator determine the actual price paid for the unregulated milk and charge the distributor the difference between the cost of such milk and the Class I price. If a rate of payment could be determined on this basis which would bring the cost to a point where it equalled the cost of regulated milk, that would represent a satisfactory solution to the problem.

It is not feasible, generally speaking, however, to determine the cost of the unregulated milk. The cost of such milk presumably would be determined on the basis of billing prices and payments. In the case of a firm which owns plants under regulation and unregulated plants, however, the billing price between such plants might be readily adjusted to avoid any payment. The level of the billing price would have no effect upon the profit of the overall operation. There are few, if any, regulated markets which do not have one or more milk distributors with outside affiliations.

In the case of unaffiliated firms, billing prices for unregulated milk might be adjusted for the mutual benefit of both parties through tie-in sales or other arrangements. Experience has proved these practices are extremely difficult, if not impossible, to regulate.



Even though it were possible to determine the actual cost of unregulated milk, it would still be next to impossible to know what rate of payment should be used to make the cost of unregulated milk equal to that of regulated milk. Milk traded between regulated dealers normally yields a handling charge to the seller. Unless regulated milk is to be at a disadvantage, it will be necessary to bring the cost of the unregulated milk up to a level above the Class I price to reflect a handling charge. What this charge should be is difficult to say. It would vary considerably according to the circumstances involved.

As an alternative, the rate of compensatory payments under most orders is based on the difference between the general level of prices at which it appears evident that unregulated milk may be available and the Class I price. Whether or not these rates are appropriate is a complicated and difficult question in itself. Conditions relative to the prices of such milk vary from time to time. No doubt order provisions can be drafted after there has been more experience with these payments which will take such variations more completely into account. Whatever the general price level of this milk, it must be assumed that dealers will buy that milk which costs them the least. During periods when substantial quantities of Grade A milk are being manufactured, it would seem logical that the cost of unregulated milk would be the ungraded milk price plus a handling charge plus freight.

Removal of compensatory payments from the orders, would permit some sales of milk which would be to the temporary advantage of the people involved in the transaction. Such advantage would be comparable, however, to that gained by individuals within the market who might obtain a Class I outlet for their surplus milk. Such advantage would, in the end, result in a breakdown of classified prices just as they have broken down in many unregulated or unorganized markets. Generally speaking, the type of transaction to which compensatory payments apply would not take place in the absence of a classified pricing program. A Class I market which is insured against competition from excess or reserve milk appears to be an attractive outlet to anyone compelled to dispose of Grade A milk for manufacturing purposes. In the absence of an insured classified pricing program, however, the market's own surplus probably would already have made the Class I outlet unattractive.

I should like to repeat at this point that compensatory payments have no other purpose than to insure that a classified pricing program will protect a market not only from its own surplus but from the surplus of other markets. Compensatory payments do not prevent milk plants from becoming associated with a regulated market. They do not determine which milk will be priced and pooled with the market. They do not provide that a plant may or may not qualify for the sale of Class I milk into a regulated market. They merely provide that if a plant chooses not to become associated with the market it may not sell its milk into the market in such a way as to destroy the effectiveness of the classified pricing program in the market.

Neither are compensatory payments a feature nor an adjunct of high Class I prices. Classified pricing programs are as common in large markets of the midwestern dairy areas as in the eastern or southern sections of the country. In order for a classified pricing program to succeed in either area, it is necessary to insure that all distributors must pay the minimum Class I price for milk sold for fluid consumption.

The protection for the Class I price to which I have referred is not intended to represent an assurance of a price which is more than adequate to bring forth the necessary dependable supplies of quality milk, including adequate reserves. Class I prices in excess of this level should not be protected.

In no case are compensatory payments, by themselves, tools by which such protection can be accomplished. If Class I prices are too high under the order program, they bear the seeds of their own destruction. Such prices bring additional milk to the market. This comes about through increased rates of production by producers and through the addition of new plants which may be attracted to the market. These additional supplies reduce blend prices and call for a reduction in Class I prices under the standards of the Agricultural Marketing Agreement Act. Most of the orders now contain provisions which bring about a Class I price reduction automatically when supplies increase in relation to demand.

Compensatory payments do not interfere with these processes which bring about reductions in prices. They do not interfere with the association of a milk plant with an order market. They provide that if the plant does not associate itself with the market, it may not sell its milk to regulated handlers on an opportunity basis which would make it impossible to maintain the Class I price level necessary to assure adequate milk supplies and insure a dependable system of distribution.



II Section On

Movement of Milk and Milk Products Into Markets

B - CRITICAL REVIEW OF  
FEDERAL MILK POOL REGULATION AND POLICY

REPORT OF FEDERAL MILK ORDER STUDY COMMITTEE

Agriculture - Washington

October 1954



I

Introductory

This paper represents a revision of a similar paper presented to the Technical Order Committee at the May meeting of said Committee.

Inasmuch as it was decided at that meeting of the Technical Order Committee that the portion of the report which seeks to explain and justify the inclusion of compensatory payment and similar provisions in fluid milk orders would be written by another member of the sub-committee, it will be unnecessary in this paper to go into a great deal of detail as to the reasons for the inclusion of such provisions in fluid milk orders. Only enough of the reasoning of the Government and other proponents of the compensatory payment provision and other provisions similar thereto will be included as is necessary to make this section of the report independent of the section to be prepared by proponents of the provisions.

II

Brief Description of Reasons for Inclusion of Compensatory Payment Provisions  
in Fluid Milk Orders.

It would not be possible to write this section of the report so that it is self-contained without some reference to the reasons for the inclusion of compensatory payment provisions and other similar provisions in milk orders. These are set forth briefly below.

Under date of July 7, 1953, the Chairman of the sub-committee on Movement of Fluid Milk and Milk Products into Milk Markets sent the Dairy Branch a letter, in which among other things, it was stated, "We would appreciate a statement of the general policy you follow with regard



to the institution of compensatory payments in milk markets . . . .". In reply, the Dairy Branch stated:

"A so-called compensatory payment type of provision of the kind now contained in several milk orders becomes operative, if at all, only after it has been determined by means of the classification and 'allocation provisions', what part of the handlers total utilization in each of the defined classes, is for the purpose of the order, considered to be from 'priced' sources and what portion is from outside or unpaid sources. In a sense, therefore, a compensatory payment type of provision may be considered as supplementary to an allocation or accounting provision. But whether or not such a supplementary provision is necessary, depends upon the actual or potential disposition of unpriced milk in the higher valued classifications. Obviously this is an integral part of the more general problem of the scope of pricing and pooling required in a given market situation." (Underscoring added)

The Dairy Branch goes on to state that a rule with respect to allocation of outside milk which is not prices is a necessary incident to <sup>1/</sup> the allocation of "producer milk" which is priced.

In direct answer to the question for a statement of general policy the Dairy Branch stated that it would be unrealistic if not impossible to make a statement of general policy dealing only with compensatory payment provisions. <sup>2/</sup>

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<sup>1/</sup> "In fact, some sort of allocation was absolutely necessary in the kind of circumstances described above in order to determine the utilization of producer milk which is, of course, a prerequisite to a determination of its value under either an individual handler pool or market-wide pool order. As may be seen, the reason for the development of this type of provision arises from the natural evolution of administrative action in translating principles involved in the process of interpretation into expressly stated rules." (Underscoring supplied)

<sup>2/</sup> "Due to the intimate relationship between the problem of the scope of pricing and the so-called compensatory payment type of provision it would be unrealistic, if not impossible to make a statement of general policy dealing only with a compensatory payment provision. Historically such provisions have been developed as a counterpart to so-called pool plant provisions, which establish requirements relating to minimum shipments or disposition or availability of milk to the market but which do not necessarily include all plants which may be qualified by health authorities or from which milk may be disposed of legally for fluid milk purposes within a given area. Consequently, the policy and justification of the particular type and amount of compensatory payment is inextricably bound up with the reasons for such limitations of pricing and pooling."

Certain facts are relevant at this point, as follows:

- (1) Thirty-nine orders contain provisions requiring payments into the pool with regard to "other source" milk that is not fully subject to the pricing and pooling provisions of the orders.
- (2) All orders contain provisions providing for progressive upward classification of "other source" milk.
- (3) Most of the orders contain "exceptions to this assignment ("other source" milk assigned to the lowest class)<sup>3/</sup>, such as in the case of emergency shortage of approved or pool milk, custom bottled milk, B milk sold outside the marketing area, proration of plant loss, etc."
- (4) The Dairy Branch states it would be "unrealistic", if not "impossible", to make a general statement of policy with regard to compensatory payments alone.

Perhaps from a review of statements made by the Department in several of the Findings and Conclusions issued when such a provision is promulgated in an order, some of which are quoted below, it will be possible to determine the general policy.

The Department of Agriculture, in a number of its Findings and Conclusions developed in the issuance of orders, or amendments thereto, which contain compensatory payment provisions, has set forth its basic reasons for the inclusion of such payments.

Perhaps the key to the policy is to be found in the argument of the Department concerning the question as to who should receive the "Class I differentials" established in fluid milk orders. The Department takes the position that, since the production of high quality milk involves extra

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<sup>3/</sup> Statement in parentheses added.

expense, it is necessary to establish some scheme under which producers who are an essential and regular part of the market should receive such Class I differential. <sup>4/</sup> (Underscoring added)

The Department reasons that Class I prices must be set as nearly as possible at the minimum levels which will encourage the necessary amount of milk production. It argues that the returns resulting therefrom should be distributed in such a way as to assure the market of the maximum dependable supply of quality milk which can be obtained at these prices. The price criterion set forth above is that Class I prices should be only sufficient to assure an adequate supply of milk for the market from those producers who are an essential and regular part of the market.

Having made this decision with respect to the level of Class I prices the Department then insists that the producers who are an essential and regular part of the market should secure the Class I differential.

Having made these decisions, therefore, it is incumbent upon the Department to write into the orders provisions which will assure or at least come close to assuring that essential and regular producers will secure the Class I differential.

Here, in essence, we have a classification of milk, not on the basis of use made of it by handlers, but on the basis of its being essential

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4/ "Since the production of high quality milk involves extra expense it is important that the amount of milk produced under Class A standards be no more than the minimum necessary to provide the market with an adequate and dependable supply of quality milk. To encourage more than enough production of such milk would represent an economic waste since the expenditure involved in producing Class A milk in an essential part of the milk supply would result in no extra value to consumers." Decision with respect to a proposed Marketing Agreement and Proposed Order, as Amended. (St. Louis, Missouri).



to the market and a regular part of the market supply.<sup>5/</sup>

This is accomplished by writing into the orders certain "performance" standards, under which, as a general rule, a plant must ship to the marketing area certain percentages of its total receipts from producers during certain periods of the year, before the plant can be included in the market wide pool.

In setting up such performance standards, in markets providing plant classification, it immediately follows that some criterion of performance must be established for the plants receiving milk from producers. Thus, it is assumed that by establishing plant standards for pricing and pooling milk, the producers delivering to such plants will receive the so-called Class I differential.<sup>6/</sup>

In the "Decision with Respect to a Proposed Marketing Agreement, and to a Proposed Order Amending the Order, as Amended, " for the New York City Market (Docket No. AO-71-A-24) the Dairy Branch follows much the same reasoning in justifying the inclusion of compensatory payments in the Order Regulating the handling of milk in the New York Metropolitan Milk Marketing Area.

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5/ "One of the primary problems, then, in setting up a market wide pool is to establish rules which will provide for the sharing of Class I sales (Class I differentials) among the producers who are an essential and regular part of the St. Louis Market. Class I prices must first be set as near as possible to the minimum levels which will encourage the necessary amount of milk production and the resulting returns should be distributed in such a way as to assure the market of the maximum dependable supply of quality milk which can be obtained at these prices." Decision With Respect to Proposed Marketing Agreement and Proposal Order. (St. Louis, Missouri).

6/ "In order to do this, provision is made that equalization of market sales should be only to plants meeting reasonable performance standards with respect to supplying milk to the market."

"Performance standards should apply equally to all plants. Any plant, regardless of its location, should have an equal opportunity to comply with the standards and to be allowed to participate in the market wide pool and have its producers share in the Class I sales of the market." Ibid.



It would serve no useful purpose here to give an elaborate description of such reasoning. However, certain relevant sections of the "Decision" will be quoted below.

"The need for a provision in the order under which payments are required on milk and certain milk products from non-pool sources (hereafter referred to as "compensation payments") arises directly from the fact that under the pooling structure of the order, as effective since 1945, some milk and milk products not primarily produced for the marketing area and therefore not pooled under the order may be distributed in the marketing area as Class I and Class II milk, (principally fluid milk and cream) without being subject to minimum class prices and pooling at source. In contrast, pooled milk necessarily is subject to minimum class prices and pooling at its source, namely the pool plants subject to the order. Classified pricing of pool milk requires that in order to secure an adequate supply of milk meeting the requirements of the market the minimum class prices for fluid uses in the marketing area must be fixed at levels higher than prices for surplus classifications and the average utilization value of all pool milk. Non-pool milk thus has an advantage over pool milk when distributed as Class I-A and Class II milk because it has not been subject to such high level classified pricing at its source. This disparity between pool and non-pool milk, must, in some manner and by some device be neutralized or compensated for if the integrity of the classified price structure for pool milk under the order is to be maintained and the declared purposes of the act achieved with respect to the New York Marketing area."

It is to be noted from the preceding statement that, having decided not to pool the milk "not primarily produced for the marketing area", a compensation payment is necessary because non-pool, but otherwise eligible milk, could undercut the class price provisions of the order and render them ineffective.

It is stated by the Branch that:

"It is, of course, apparent that if the order were to price and pool all milk received from all farmers at any plant from which any milk or milk products enter the marketing area for Class I-A and Class II use these disparities would not exist because all such milk would then be pool milk and would be subject to pricing and pooling under the order. Drafting of the order in such manner, however, has been found from experience not to be feasible or practical, and an order so drafted did not and could not now effectively accomplish the declared purpose of the Act." (Docket No. AO-71-A-24).

Certain other relevant sections of the "Decision" are quoted below as follows:

"Having defined producers and pooled milk as heretofore and herein found to be necessary, in a way which does not include all milk which may enter the marketing area, it automatically and inevitably follows that an opportunity exists for the sale of unpriced and pooled milk in the marketing area since the minimum class prices and pooling established under the order pursuant to Sections 8c(5) (A) and (B) of the Agricultural Marketing Agreement Act of 1937, as amended, are applicable only to milk received from producers as defined in the order. Such minimum class prices and pooling do not and cannot apply to milk received from farmers who are not pool milk producers. If that milk which is available and eligible for sale in the marketing area from farmers who are not producers and which consequently is unpriced and unpooled under the order is not regulated in some manner, however, the minimum class pricing and equalization provisions of the order would be rendered ineffective. In the absence of some suitable form of regulation of such unpriced milk there is always an artificial economic incentive for milk from non-producer sources to enter the marketing area and displace milk from producers. Such non-producer milk would be milk which would not have entered the marketing area in the absence of a class price plan but would be induced to come in for use in the relatively high valued fluid outlets solely because of the competitive advantage created for it by the classified pricing and pooling of producers' milk. The exclusion of such milk from the marketing area is not authorized or desirable. The only alternative method or device which has been suggested or proposed for dealing with the situation is to impose a suitable charge on such unpriced milk in an amount sufficient to neutralize, compensate for and eliminate the artificial economic advantage for non-pool milk which necessarily is created by the classified pricing and pooling of pool milk under the order." 7/

Here again, it merely suffices to note that, once having made the decision to exclude qualified milk from the pool, the Dairy Branch has found it necessary to establish compensatory payment provisions in the order so that such milk will not be in a position to undercut the classified price provisions of the order.

Prior to closing this section, it should be noted that prior to 1945, no compensatory payment provision was included in the New York Order.

The Branch states as follows:

"Prior to 1945 all milk received from farmers at all plants approved by marketing area health authorities as sources of fluid milk for the marketing area was included in the pool and was therefore class priced at its source under the order. Under that plan there was no problem of unpriced milk, because all milk which was lawfully distributed in the marketing area for fluid purposes as well as all other milk at the plant from which it originated automatically was in the pool and subject to classified pricing at its source. Because of serious weaknesses which developed under this loose plan of pooling, the order was amended in 1945 to limit the pool, insofar as possible, to milk which was primarily associated with the New York fluid market either as regular or reserve supplies and to exclude from the pool milk which was primarily associated with some other fluid market or manufacturing outlet even though it had the health approval of one of the marketing area health authorities. This necessarily left out of the pool, and not subject to class pricing at source, quantities of non-pool milk which could enter the marketing area for fluid use because of its health approval." 8/

Here, attention is called to the language ". . . the order was amended in 1945 to limit the pool, insofar as possible, to milk which was primarily associated with the New York fluid market either as regular or reserve supplies and to exclude from the pool milk which was primarily associated with some other fluid market or manufacturing outlet even though it had the health approval of one of the marketing area health authorities."

(Underscoring added)

Having decided to "limit" the pool, it then becomes necessary, in order to protect or maintain the classified price and pooling structure, to place compensatory payments on non-pool milk which is qualified otherwise for distribution in the marketing area.



From the foregoing, it appears that the policy of the Dairy Branch embraces the following points:

(1) Class I differentials should be placed at the level necessary to call forth an adequate, but no more than adequate, volume of milk qualified by health authorities for distribution in the marketing area.

(2) It is necessary that this Class I differential be distributed only among producers who are an essential and regular part of the market supply.

(3) Inasmuch as there is or may be milk qualified by health authorities for distribution in and available to the marketing area which is not, or may not be, essential to an adequate supply for the marketing area, or a regular part thereof, some method for pricing this milk is necessary in order to maintain the integrity of the classified price and pooling plan set forth in the order.

(4) Compensatory payment provisions have been developed in line with effectuation of the reasoning set forth in (1), (2), and (3) above.

The preceding statement serves to explain in sufficient detail for the purposes of this paper the position of the Department of Agriculture and the reasons advanced by the Department and other proponents for the inclusion of compensatory payment and allied provisions of fluid milk orders. For the purposes of this paper, it was not deemed necessary to describe in detail the manner of application of compensatory payments in each order. Here, we are concerned with the principle involved, not the details of application which may vary from order to order.

In the following sections of this report, the position of the Department of Agriculture will be subjected to examination and evaluation.



### III

#### Classified Pricing and Pooling Plans - Their Evaluation and Nature

In order to develop fully the reasons the author of this paper believes compensatory payment provisions and other similar provisions of the orders to be restrictive devices, it would appear desirable to set forth first, the nature of classified price and pooling plans, how these plans were adopted in the development of the Agricultural Marketing Agreement Act of 1937, and how these plans, when they are spread to cover the entire market, either through large scale organization of supply or because of Government implementation of such schemes, may lead to arbitrary pricing, and to the development of devices which limit the entry of milk into a fluid milk market.

It is fairly well recognized that classified price plans were originally developed in fluid milk markets as a part of the bargaining program of cooperative associations in selling the milk of their members to distributors. It has been shown that large scale organization of the supply of milk is necessary for the development of such plans. In Some Problems Involved in Establishing Milk Prices, Chapter 4, The General Theory of Milk Prices, the following statement is found:

"The facts and considerations concerning large scale organization of the milk supply were set forth in chapter 2, section I. There it was shown that in many milk markets a large portion of the market supply is sold by the cooperative association, or at least is sold on the basis of a scheme of prices bargained for by the cooperatives. In other words, although the production of milk is carried on by numerous producers, each of whom produces an insignificant portion of the total amount of milk produced in the supply area, the sale of such milk is handled practically as a unit....."

"As was pointed out above, none of the theory already advanced explains the reason for the development of the classified-price plan of selling milk to distributors. This is because the major element necessary for the formal development of such a price plan, namely, large scale organization of the supply, has not been introduced. Once this element is introduced the entire structure becomes subject to simple ratiocination in a general way. The possibilities for the development of price plans and policies become readily apparent once the multitude of small producers is replaced by an overhead organization that acts as their sales agent. ...."

"Following the generally accepted principle that, by and large business institutions operate in a manner that they consider most conducive to their interests, it appears reasonable to believe that classified pricing has become the ruling method of sale to distributors in most large markets because experience has proved that such a method may obtain for a given volume of milk a larger sum of money than might be obtained by other methods which might have been developed. This statement is strongly supported by the theory of commodity price discrimination, advanced in chapter 5, section IX. On the other hand, it may have developed because of its convenience, as is suggested in chapter 2, Section II, that is, because it is a rather convenient method of evaluating milk for purposes of sale to distributors. In any case, the institutional aspects of the matter must be realized before it is possible to obtain real understanding of the operations of the larger milk markets. Once these aspects are realized, inquiry into the economics of the milk trade is facilitated and proper emphasis can be placed upon ascertaining the influence of large-scale organization of the supply and of the distributive phase of the milk trade upon the price structure for milk. ...."

"Large-scale organization of the supply is also necessary for the development of formal pooling, i. e., the development by the cooperative of rules and regulations pertaining to the manner in which the proceeds of sales to distributors will be pro-rated to producer members.....Formal pooling thus is practically a natural concomitant of formal pricing of milk to distributors. ...."

It is seen from the foregoing that the price structure in most milk markets, particularly the larger markets, was one determined under large scale organization of supply. Competition is between groups which control a significant volume of milk in relation to the total market supply.

Under such circumstances, the price structure is explained under the principles of what is sometimes called "monopolistic competition", and various and sundry marketing schemes, such as classified price plans, have their origin in this type of competitive situation.

Classified price systems lend themselves very readily to the development of arbitrary prices in fluid milk markets, through the practice of commodity price discrimination, diversion of milk between markets or use outlets, and the like. A rather comprehensive treatment of the manner in which this may be accomplished is given in the bulletin referred to above, and by Cassels, J. M., and Sorenson, Helen, The English Milk Market, Quarterly Journal of Economics, February, 1936. (See also Robinson, Joan, Economics of Imperfect Competition, chapter XV, for a general treatment of price discrimination.) It is unnecessary to quote extensively here from the bulletin, "Some Problems Involved in the Establishment of Milk Prices." It merely suffices here to quote certain conclusions of the section referred to, as follows:

"The extent to which commodity price discrimination will be practiced will depend in large part upon: (1) The extent to which the total market supply is controlled by the cooperative; and (2) the availability of alternative product markets, which products have a less inelastic demand curve than fluid milk, or with respect to which the seller is operating under conditions of simple competition...

"The extent to which the total market supply is controlled by the cooperative is a factor of major importance in determining whether it would be feasible to practice commodity price discrimination in any particular market. It has been shown that the demand for milk is much more inelastic than the demand for other dairy products, especially for those manufactured dairy products with respect to which the output of the cooperative is an insignificant portion of the total production of the country.



Thus the greater the degree to which the cooperative controls the total supply of milk available in the market, the closer the demand curve for the milk sold by the cooperative will approach that of the market as a whole. Similarly, the demand curve for the milk sold through the cooperative will become more and more elastic as the proportion of the total supply controlled by the cooperative declines. Hence under complete control the extent to which commodity price discrimination is practiced will probably be found to be greater than when a smaller degree of control is exercised. With a small degree of control, the cooperative would merely deprive member producers of their market if it insisted upon arbitrary prices for that portion of their milk sold as fluid milk....."

It may appear that the preceding treatment of the nature of classified price plans, and the pooling plans which accompany them, condemns the use of such plans by cooperative associations as being monopolistic in nature, and therefore wrong and illegal. This is not the case. While it is true that these marketing devices have their origin in markets operating under conditions of large scale organization of the supply, called by some monopolistic competition, nevertheless, the degree to which the cooperative could bargain for and secure arbitrary prices would depend upon the degree of control of market supply which it can exercise. It is perhaps true that only in a very few markets is the supply so tightly held by the cooperative that it can exact demonstrably arbitrary prices. Even here, the continued threat of attracting other, non-cooperative milk into the market serves, in the opinion of the writer, as a marked deterrent to arbitrary prices in such markets.

The nature of the price structure for milk in organized markets, however, becomes of most pressing importance when it is realized that the marketing devices shown herein to be conducive to the development of arbitrary price structures are made market wide by the application of a Federal order. Prior to the development of orders, it is probable that

competition from non-member producers and other sources of supply tended strongly to keep the prices which could be bargained for in the market relatively free of demonstrably arbitrary elements. However, if the Government, by making such schemes market wide in scope, then undertakes to limit the movement of milk into the market, it should be quite obvious that the stage is set for the development of arbitrary and capricious price structures and pooling devices on a vast scale, without the deterrent of competition from other milk which served to hold down the arbitrary element in prices that could be negotiated by the cooperative. In other words, the Federal Government can make such devices the tools of arbitrary pricing without any check or balance, other than its own volition.

In the next section of this paper, it will be shown that, through the inclusion of certain provisions in the orders, such as compensatory payments and similar devices, the Government is in fact lending its regulatory power to the development and maintenance of arbitrary price structures which it is believed are inimical to the interests of producers other than those protected by such provisions in orders, and against the public interest.

#### IV

##### Appraisal of Compensatory Payment and Similar Provisions of Milk Orders

This section will be devoted to an appraisal of the practice of the Department of Agriculture in instituting compensatory payment provisions and similar provisions in milk orders.

1. Legal Aspects.---The writer of this paper is not an attorney, but will set forth below his opinions in this matter---opinions which have been developed over some years of experience with administering milk orders.

To the knowledge of the writer, the question as to the validity of compensatory payment and similar provisions of Federal Orders has not been finally adjudicated. After a Federal Court decision in favor of the Department in the so-called Babylon Case, such decision was reversed on appeal to the Circuit Court, with Judge L. Hand dissenting. The United States Supreme Court refused to hear the case.

The opinion of the Circuit Court held, briefly, that the provision was violative of 8(c) 5 A of the Agricultural Marketing Agreement Act of 1937, in that it failed to fix uniform prices among handlers.

The writer of this statement, having in times past had considerable experience in the administration of fluid milk orders, takes the following position regarding compensatory payments:

(1) Compensatory payments, or any similar device, are not authorized by the Act.

(2) Compensatory payments, or any similar device, violate Sections 8(c) 5 A and 8(c) 5 (G) of the Act, for the reasons that:

(a) It is not possible to price milk uniformly to handlers through use of such a payment provision; and

(b) Such provisions are directly violative of Section 8(c) 5 (G) which states: "No marketing agreement or order applicable to milk and its products in any marketing area shall prohibit or in any manner limit, in the case of the products of milk, the marketing in that area of any milk or product thereof produced in any production area of the United States."



While it may be argued that the provision 8(c) 5 (G) applies only to products of milk, it seems to the writer that such argument is fallacious for the following reasons:

(a) The proponents of this section in the Congress have advised the writer their intent was to prohibit limitation of the marketing of milk in any of its various forms in any marketing area;

(b) The section specifically states "the marketing in that area of any milk . . .".

2. Evolution of pooling in fluid milk markets.--It has already been shown (Section III of this report), that the development of wide scale pooling in fluid milk markets was one aspect of the growth of large scale organization of the supply of milk from producers into cooperative associations. The period of perhaps greatest development was during the late 'teens and twenties. Prior to the development of marketing cooperatives on a large and significant scale, about the only pooling that existed, if such it can be called, was that practiced by the individual handler who paid uniform prices to producers, subject to fat, transportation, and other factors.

The major difference in pooling as practiced by cooperative associations and as practiced under Federal orders perhaps is with regard to the matter of the scope of the operation. Cooperative associations pooled the sales of their members milk, and the degree to which such "association pools" approached a market wide pool depended upon the size of the cooperative volume in relation to the total in the market.

Under association pools, there was always a greater or lesser volume of milk not subject to the pooling apparatus, and, of course, not subject to sale under the classified price or other plan developed and used by the cooperative association in selling the milk of its members to handlers. Under such circumstances, there was, therefore, considerable competition within the market between supplying groups. Such competition, due to lack of uniformity as to selling prices to cooperating handlers and non-cooperators, and differences in pooling arrangements among cooperative associations when there were several operating in the market, has frequently been cited as one of the major reasons that milk markets, or at least some of them, exhibited marked elements of uncertainty, unsettled conditions in marketing, and the like, prior to the advent of wide scale Federal regulation. In some circumstances, such competition and resulting price problems led to milk strikes and the actual stoppage of milk supplies to the markets involved. However, in the absence of actual strikes, in which the degree of milk stoppage relative to the total volume of milk consumed over any fairly extended period, say several weeks or months, was usually quite small, there appears to be no evidence available that the competitive circumstances referred to above resulted in shortages of milk supplies for consumers in city markets.

Federal regulation is patterned directly upon the scheme of marketing developed by the cooperative associations during the twenties and early thirties. The classified price plan of pricing milk to handlers, and the various and sundry pooling plans of paying producers, had their origina in the plans developed by the associations. The only major difference

is the scope of the operation under Federal regulation as compared to bargaining and sales programs of the cooperative associations. Federal regulation was designed to make market wide the marketing programs developed earlier by the cooperatives, the idea being that by making such programs market wide, many of the competitive aspects of the business under association bargaining and pooling would be eliminated.

Attention is called to the fact that the term "market-wide", as used above, applies to the supply of milk of which a part or all was sold in the marketing area. By limiting the full application of the orders, the Dairy Branch thereby faces much the same problem in making operative its classified price plan and pooling arrangements as was faced by the cooperative. The cooperative, in order to meet this situation, had to keep its prices rather well in line with the competitive situation. The Department of Agriculture, through its orders which provide for market-wide pools, can and does eliminate the element of price competition on the part of handlers in securing milk from producers, except when handlers pay premiums.

Federal regulation of milk marketing under orders is mandatory upon the handler and upon the minority of producers who might not desire to follow the particular marketing scheme involved. Competitive aspects in procuring milk from producers are largely eliminated, at least with regard to price competition.

From the foregoing, it is quite obvious that:

(1) Competitive factors were operative to limit the degree to which cooperative associations could establish arbitrary pricing in fluid milk markets. The greater the degree of control of supply, the greater the possibility of developing, for want of a better term, what we



may call "artificiality" in pricing. The lesser the degree of control of supply, the lesser would be the degree of "artificiality" in pricing on the part of the cooperative association.

(2) Under Federal milk orders, all competition in procurement of milk from producers has been eliminated (except for premiums which handlers may pay). Therefore, under Federal regulation, there is no restraint upon the levels of prices which may be established by the Department, except the restraint imposed by the Department upon itself. Even here, the Department does not have a free hand. Orders, and amendments to orders, under the Act are subject to approval of producers before they can be instituted. Thus, if the Department proposes changes in prices that are not approved by producers, the only recourse of the Department is to either acquiesce to the wishes of local producers, or to suspend or terminate the order.

If, therefore, the Department establishes provisions in fluid milk orders which limit or restrict the entry of milk into the market, in conjunction with classified price and pooling plans which are explained only by reference to the economics of monopolistic competition, it has set the state for monopoly pricing backed up with all the vast enforcing powers of the Federal Government. (See also Section III.)

3. Exclusionary aspects of pool plant limitations, compensatory payments, and methods of classification upon entry of milk into fluid milk markets operating under Federal orders.--The Department states that its scheme of plant (pool) definitions and provisions relating to compensatory payments and classification of "other source" milk do not constitute any limitation upon the entry of so-called "other source" milk into fluid milk markets under Federal regulation.

Perhaps it might be desirable at this point to reiterate the arguments of the Dairy Branch, set forth in the preceding Section I of this report, briefly as follows:

- (1) High quality milk production is more expensive than milk not produced under such high quality standards.
- (2) It is important that no more than enough milk be produced for the market requirements,
- (3) Accordingly, Class I differentials should be pro-rated among those producers who are an essential and regular part of the market, and as a result of the foregoing reasoning, it follows that standards for participation in the pool by plants selling milk in the market must be set up.

From the foregoing, it appears that the concept of essentiality and regularity is a determining factor in the establishment of the pooling plan and in defining the milk that will be pooled. "All of these arguments have some elements of reasonableness and authenticity. The question, or so it would appear, is how is essentiality determined? Is the regulation to be applied to a selected group, without regard to their ability or lack of ability to meet the competition of other producing areas?

It is probable that all could agree that the establishment of Class I differentials at a level which will call forth the requisite supply for the market is a sound principle, but whether these differentials should be set at a level to assure an adequate supply from local sources is another matter indeed. It is true that many milk markets meet their needs from local sources, whereas it is equally true that other areas must import a greater or lesser volume of milk from more distant sources. Some markets

have in the past been chronically deficit markets, insofar as local production is concerned. Therefore, it would appear that in the setting of Class I differentials, reasonable care should be exercised to see to it that uneconomic production within a high cost area is not fostered, and supplies from other more efficient production areas are not discriminated against.

Also, in connection with this expressed ideal of the size of the "Class I differential" by the Dairy Branch, we have the question as to whether such ideal is borne out, or even closely approximated, in practice. The question, or so it would appear, is whether prices are in fact established at minimum levels necessary to secure an adequate supply? If a market is one faced with chronic surpluses, the only reasonable conclusion would be that prices have been and are being established at arbitrarily high levels. What, under such circumstances, becomes of the proposition that "Class I differentials" should be pro-rated among those producers who are an essential and regular part of the market?

When supplies are far in excess of fluid milk requirements, it would appear that there are large numbers of producers on the market who are not essential. This being obvious on its face, it follows that as a matter of practice, "Class I differentials" in such markets are being distributed not only to essential producers, but to many who are not essential, in terms of assuring an adequate supply for the market.

From the foregoing, it would appear that, in surplus markets, the reasoning of the Dairy Branch, in regard to pro-rating "Class I differentials" to essential producers, is fallacious as long as prices are kept at levels



that maintain or increase the market surplus. In such markets, as a matter of fact, "Class I differentials" are being pro-rated among producers who are not essential. Therefore, the inclusion of compensatory payment provisions in orders regulating the handling of milk in such markets based on the necessity of seeing to it that essential producers receive the benefit of the "Class I differentials", would appear to rest upon a false foundation--false when considered in relation to the arguments advanced by the Dairy Branch itself, and even more false when considered in relation to the Act.

In view of the foregoing, it would appear that, if the criterion of essentiality as determining the scope of the regulation is to be adopted, then, when markets are faced with a chronic surplus, as many have been for many years, at least during relatively normal times, the Department in order to carry its findings through to a logical conclusion, should also adopt the policy of excluding the milk of those producers or plants which are not considered "essential", by re-defining the pool plants so as to progressively limit the number of plants in the milk shed, thereby reducing the surplus to more manageable proportions. Although this may not be the long time goal of the Department, nevertheless, there is nothing except its own sense of restraint that would keep it from doing so, if we are to have a mere statement of "essentiality" as the determining factor, with the essential producers and plants, as defined, granted complete freedom from price competition and supply competition from sources that desire to enter the market.

The Department, in arguing that compensatory payment provisions are not restrictive, states as follows:

"It should be emphasized again that the purpose of the compensatory payment charge is merely to remove the disparity as between pool milk and non-pool milk at the initial marketing level when the pool or non-pool milk is received from farmers."

And again,

"This payment is not designed, however, as a means to exclude milk from the market, or to assure any group of producers that they alone will be permitted to supply the market. Any plant which cares to do so is eligible to meet the performance standards and qualify as a pool plant fully subject to the provisions of the order, and assume the responsibility of serving the market. The payment is not designed to maintain prices above those needed to insure an adequate supply of wholesome milk. As pointed out anyone may join the pool and if prices are higher than necessary it may be expected that the added production from old and new producers would expand supplies beyond the levels required by the market. The order contains a provision which would automatically reduce prices if such increase took place. The payment would not discourage association of dependable milk supplies with the market but as pointed out heretofore might be a means to facilitate such association in the case of handlers largely in the fluid milk business on the fringes of the market."

It is to be noted that these statements need to be most carefully considered. While the Department may state that its purpose is not to restrict the entry of fluid milk into a fluid milk market, but to remove any milk cost disparities that may exist between priced and unpriced milk, the mere statement does not make it so. Most assuredly, under competitive conditions, in this instance meaning competition in milk procurement without being subject to the provisions of a Federal order, no such thing as a "compensatory payment" would exist, nor did such payments in fact exist prior to their development as a part of the scheme of Federal regulation. Therefore, such payments are not, and cannot be authorized by Section 8(c) 5(B)(ii) of the Act, which provides:

" . . . (ii) for the payment to all producers and associations of producers delivering milk to all handlers of uniform prices for all milk so delivered, irrespective of the uses made of such milk by the individual handler to whom it is delivered;

"subject in either case only to adjustment for (a) volume, market, and production differentials customarily applied by the handlers subject to such orders, (b) the grade or quality of milk delivered, (c) the locations at which delivery of such milk is made, and (d) a further adjustment, equitably to apportion the total value of the milk purchased by any handler, or by all handlers, among producers and associations of producers, on the basis of their marketings of milk during a representative period of time."

Sub-paragraph (d) preceding is the language in the Act which authorized the institution of base-rating plans in fluid milk orders.

Milk would enter the market as economic conditions warranted, and while the prices might be different in some degree from the ruling scale for association milk in the market, they would no doubt in time bear some close relationship to such prices.

Under usual competitive circumstances in markets not operating under a Federal order, and where the supply was not under full control through being handled or sold to handlers through a cooperative association, coupled with a full supply contract between the cooperative and the handlers in the market, competition in milk procurement would result through (a) non-cooperating handlers receiving their milk at lower prices than those provided in the classified price plan of selling adopted by the cooperative, and (b) from outside sources of supply which would try to enter the market if prices were high enough to warrant such effort.

Under the Federal orders, with the supply of milk limited by reference to certain "performance" standards of plants in the supply area, and with any differences in prices of milk from outside sources "compensated" for by a charge on the receiving handler, it is submitted that, in spite of the protestations of the Department that it does not intend to limit the



entry of milk into a fluid milk market, and does not do so, the technique followed is perhaps the most effective method yet developed to exclude milk from the market. There appear to be several excellent reasons for this conclusion, as follows:

1. The mere determination of a percentage requirement whereby a plant must ship a given percentage of its receipts to the market during certain periods of the year is in and of itself a barrier to the expansion of the business of a handler, judged from the viewpoint of the situation that would prevail under conditions of price competition in the procurement of milk from producers. Price levels under an order limit, and in fact it is believed practically eliminate, competition in the procurement of milk from producers. Irrespective of the situation of a given handler in the market as compared to his competitors, he must pay the same price for milk of the same use as all other handlers. Gains in business are to be had by merchandizing effort and increases in efficiency--not by gains due to the procurement of a cheaper source of milk. There is no reason to decry this fact--inasmuch as there seems little reason to believe that there should be major differences in milk costs between handlers, and under non-regulated conditions, it is probable that such costs would be fairly uniform between handlers due to the operation of competitive forces.

Of perhaps equal importance in regard to the question as to whether all handlers should pay the same price for milk entering the same use, it is to be noted that one of the major purposes of the Act (Marketing Agreement Act of 1937), was to remove this possibility of different cost of milk between handlers, thereby contributing, or at least so it was thought,

to stability in the market. In other words, practical elimination of competition in milk procurement among handlers, at least price competition, is specifically authorized by the Act, even though there can be little question that such elimination does not inhibit competition of one sort among handlers, and may have some tendency to limit entry of milk into the market.

It does not follow, however, that supply competition should be limited under an order, or that the limitation of such competition is authorized under the Act. If milk from new sources can come into the market under the Class price schedule established, it should be permitted to do so.

2. The development of "pool plant standards", and its companion provisions of compensatory payments and methods of allocation of milk for classification purposes between producer and "other source" milk, undoubtedly inhibits the entry of milk from outside sources. Handlers enter the market because they see a chance to develop a more remunerative market for their milk, either through direct distribution, or through becoming supplying handlers for other handlers already established in the Class I business of the market. Such handlers have to have an approved source of milk, from producers qualified by appropriate health authority, and therefore following the reasoning of the Department of Agriculture regarding Class I differentials and the necessity for such differentials to be spread over qualified milk because of additional costs of production of Grade A milk, presumably must be in a position to return to their producers sufficient margin over the cost of producing manufacturing milk to enable them to meet Grade A requirements.

By the device of "pool plant standards" and "compensatory" payment provisions, however, any handler who wishes to enter a market is denied the privilege of returning to his own producers the additional value represented by the Class I sales he may secure in the market, and is denied payments from the equalization pool. All the additional returns he might acquire for passage back to his own producers are siphoned off through the devices named above, and are diverted to so-called "regular" or "essential" producers. Accordingly, irrespective of the price levels set in the market, new handlers are, by virtue of the operation of the pool plant provisions and accompanying compensatory payment and "other source" milk accounting provisions, definitely limited in their abilities to enter a fluid milk market. It does not suffice for the Department of Agriculture to state that any handler or plant, wherever located, may if it so desires become qualified by the shipment of the required quantities of milk to the market and thereby become full fledged handlers or "pool plants" under the orders, when the regulations keep the handler who desires to enter the market from returning to his own producers either the benefit of his Class I sales that he might acquire, or equalization payments from the pool to pass along to his producers to meet the additional costs of producing Grade A milk. Under the scheme of regulation, it should be quite obvious that about the only method for a new handler to enter the market while at the same time developing a source of Grade A milk from his producers, is to buy out some established handler.

It should be noted also that the compensatory payment provision may markedly inhibit the expansion program of an established handler in the market. If such a handler, for example, desires to develop a new



plant to meet his needs or for expansion, the compensatory payment provision would place him in about the same position as that of a new handler entering the market. He would have to qualify his plant under the "pool plant" provisions, else be subject to payment of compensatory payment provisions.

3. The term "compensatory payment" carries with it a very definite connotation that so-called "essential" or "regular" producers are being compensated for something to which they have an inherent right. This assumption of inherent right needs very close examination.

In the first place, under competitive conditions in milk procurement and absent complete association or Federal control of the milk supply sources of the area, producers share in the fluid milk price structure for the market only in relation to the degree to which competitive forces operating among handlers determine the distribution of business among handlers in the market. Those who sell to high utilization handlers, are, by and large, better situated to secure full value for their milk than those associated with low utilization handlers. In time, competition brings about a fairly close correlation between prices received by producers supplying different handlers in the market.

Under equalization, it makes no difference to the individual producer whether his handler is a high utilization handler. Through the equalization process he receives the same price as any other producer similarly located, irrespective of the utilization of the handler to whom he delivers his milk. However, under competitive conditions, in time practical equalization of prices to producers would take place, inasmuch as low utilization handlers would be trying to secure higher utilization,

and high utilization handlers would still be trying to increase their business. The latter effort probably almost inevitably involves the high utilization handler in problems of disposition of milk that is surplus to his fluid milk requirements, the daily and seasonal excess, since as his sales of fluid milk increase, he has to carry a greater absolute volume of surplus milk.

The question arises as to when and under what conditions the local producer is deprived of income for which he must be "compensated" by an order provision.

A number of markets in the country are deficit markets, in the sense that local production is not sufficient during all or some part of the year to meet fully the fluid milk requirements of the urban population of the marketing area involved. Under such circumstances, the local producers cannot be said to be meeting their responsibilities to supply the market. However, it is quite easy to be glib about the responsibility of the producer or the handler in supplying a market. Supplying a market is a function of supply and demand conditions, and there is no moral obligation on any producer or distributor to continue or start a milk business. This would be determined by the economic conditions. The mere fact that local production is not sufficient to supply the full fluid milk requirements of a given city population merely means that, taking account of production conditions within the local portion of the supply area, local producers are not able to meet the competition of other sources of supply to the degree sufficient to capture the entire market. It may be argued that the intent of the Agricultural Marketing Agreement Act of 1937 was to assure the development of sufficient local supply to meet all the needs of the market,

but this is indeed a far fetched interpretation of the Act.. To so argue would indicate that the Act of 1937 was specifically designed to encourage the production of milk in high production cost areas. To do so would involve the establishment of price structures that are high in relation to the prices at which milk could be shipped into the area. The establishment of such arbitrarily high price structures would necessarily carry with it some provisions designed to keep out milk from lower cost areas, and if this were done, the Agricultural Marketing Agreement Act of 1937, which was designed to remove "burdens and obstructions" on interstate commerce would in actual fact be used to inhibit the flow of milk and its products in interstate commerce--a result that most assuredly was not desired or expected when the Act was passed.

In its methods of accounting for "other source" milk, the Dairy Branch has developed the policy and technique of accounting for all local milk at the higher class uses. "Other source" milk is accounted for at the lower classes, progressing in the application of such milk to the different classes from the lowest to the highest classes.

This method of accounting for "other source" milk therefore tends to allocate all local production to the highest use classes. The question is, is this a proper method of allocation?

It is frequently assumed that all local milk should be allocated to the highest use class, the idea being that such milk carries lower transport costs, and the like. Ordinarily, this would appear to be a reasonable thesis. However, such a thesis assumes that local milk would be priced in any event, even under non-order conditions, at the top price prevailing in the market. Perhaps this might be true in deficit markets, but it is quite seriously to be doubted. In some markets, prior to the advent of



the Federal order, some of the local milk was priced at the surplus price prevailing in the market, irrespective of whether the market needed imported supplies during the season of short production, or for that matter, during the entire year.

It is interesting to note that, when local producers are meeting the full requirements of a fluid milk market, some of their milk will always be priced at the surplus price, due to the fact that, in order to meet the requirements of the market for fluid milk, sufficient milk must be produced, over and above average daily sales, to meet daily variations in sales, and seasonal variation factors. While no precise figure can be quoted regarding the size of the so-called "necessary surplus", it is commonly thought to be about 15 percent of Class I sales in the marketing area. Therefore, we have the anomolous situation where local producers who do not fill the full requirements of the city population in their marketing area for fluid milk tend to have all of their milk accounted for as Class I milk to the limits of their production, whereas in areas where the local producers fully meet the requirements for fluid milk, such local producers will receive surplus prices for about fifteen percent of their total production. It would appear therefore, that the method of accounting for local milk to the full extent of production at the Class I use, particularly in deficit markets, gives them a greater share, relatively, of the fluid milk market than producers who fully meet their so-called responsibilities to supply the market requirements for fluid milk. Such procedure is, to say the least, highly questionable.

4. Discrimination between producers.--It is submitted that "pool plant" definitions, compensatory payments, and methods of allocation of "other source" milk constitute an unjustified scheme of discrimination between qualified producers.

As has been noted hereinbefore, producers, except producer handlers, have their entree to the market through their relationship to a handler in the market. He may be a high utilization handler, a low utilization handler, or somewhere in between such extremes. The producer, if he desires to enter a fluid market, must on his own responsibility qualify his farm pursuant to the applicable local sanitation regulations. From there on, his ability to enter the market depends upon securing a market for his milk through some handler (including cooperative associations). Any regulation which causes the handler to whom he sells his milk to withdraw from the market, or places such handler either in fact or potentially in a disadvantageous position with other handlers, is not only a discriminatory practice relative to the handler involved, but in the final analysis a discriminatory practice against the producers selling to such handlers.

It does not suffice to state that "fringe" handlers may desire the compensatory payment provision rather than be subjected to the full scope of order regulation. The discrimination basically is against his producers, rather than being lodged only against the handler per se.

Further, it does not suffice to argue that any handler, by meeting the requirements of the order regarding "pool plant" definitions, is not limited by application of the compensatory payment provision.

We think it has been shown that such payment provisions do limit the entry of qualified milk into the market.

In addition, the writer of this statement has had his attention called to the fact that certain handlers have withdrawn from milk markets when compensatory payments were instituted.

5. Individual Handler vs. Market Pools.--The Agricultural Marketing Agreement Act of 1937 permits the institution of two types of pools under Federal milk orders, namely, the "individual handler" and the "market wide" type of pool. Under the former, the use values of milk of the individual handler are pro-rated over the producers delivering milk to him. Under the latter, the use values of all milk in the market are pooled, and a weighted average price for all producer milk in the market is calculated.

Nine Federal milk orders provide for individual handler pools. Under such orders, no provision is made for compensatory payments.

It would appear that, under individual handler pools, the Department, in instituting such pools, must have the basic assumption that individual handler pool prices will tend to work out so that prices to producers throughout the market are fairly uniform. Here, perhaps, is a basic factor. Under handler pools, price competition is not so completely eliminated as under market pools. The prices the individual handler can pay depend upon (1) the class price structure, and (2) his use of receipts from producers. Under this type of pool, the handler can adjust his utilization and receipts from producers so that he approaches the market average. This he must do in order to keep his producers, else pay them a premium.

In regard to market wide pools, the Department has found it necessary to limit the pool to milk primarily associated with the market, and to exclude from the pool milk which was primarily associated with some other fluid market or manufacturing outlet even though it had the health approval of one of the marketing area health authorities. (See Section I of this paper). Inasmuch as the phrases "limit the pool", and "exclude



from the pool" certain types of milk were taken directly from official statements of the Department of Agriculture in justifying the inclusion of compensatory payment provisions in market pool orders, it is submitted that the Department thereby admits that it restricts the entry of milk under market pool orders which contain compensatory payment provisions.

It is submitted here that this is done in order to restrict entry of milk under market pools, and thereby protect the pool, which is short-hand for the establishment of devices designed to give so-called "essential" and "regular" producers a monopoly of the fluid milk business in markets operating under market pool orders. It is a device designed to short circuit the element of supply competition.

Under individual handler pools, on the other hand, the Department apparently feels that supply competition, so derogated under market pools, will operate to bring about substantial equivalence of prices to producers delivering to different handlers under individual handler pools.

It is submitted that this is a most inconsistent position.

6. Scope of the regulation.---Proponents of compensatory payment provisions maintain that the provision is an integral part of the broader problem of defining what is to be regulated under the orders. (See also Section I.)

Of course, it is quite obvious that the scope of the regulations embodied under an order must be defined. It does not follow, however, that the scope of the regulations must be defined in such a manner as to limit the full price and pooling provisions of the regulation to only certain portions of the milk qualified and available for the market.

III Section On  
Administration  
of  
Federal Milk Order Program

REPORT OF FEDERAL MILK ORDER STUDY COMMITTEE

Agriculture-Washington

October 1954





Section on Administration  
of  
Federal Milk Order Program

I. Speed and Effectiveness of Administration

- (a) Hearing procedure, including the original promulgation hearings and amendment hearings and including pre-hearing, hearing and post-hearing.

(i) Original Promulgation Hearings

The Committee has no suggestions or recommendations as to handling of the procedures for the original promulgation hearings any differently from the methods now being used, except one minor one. Present methods seem fairly well designed to take care of the programs. There are so many wide variations between the situations in different markets where orders may be sought that no improved standard methods could be prescribed as to pre-hearing procedures. Promulgation hearings need to be very much of the public forum, town meeting type for the sake of the public relations and public and industry education functions involved as distinguished from the mere necessity for establishing a record of probative evidence as a basis for the action to be taken.

The minor suggestion as to improvement in the original promulgation hearing procedure is that the hearing notice be at least thirty (30) days in advance and that all government statistical data be furnished to interested parties at the same time as the hearing notice.

(ii) Pre-Hearing Notice Procedure - Amendment Hearings

The suggestions under this heading relate to the handling of petitions for amendment hearings.

Petitions should be more carefully screened.

The next step in the pre-hearing notice procedure should be one generally now used but which is stated here for the sake of completeness, that is, the publication of a notice or invitation giving other parties the right to submit petitions on the same or closely related subjects.

After the completion of all petitions the hearing notice should be issued promptly. No specific General Regulation is necessary to bring about such prompt action inasmuch as the Administrative Procedure Act in Section 6(d) provides for such "prompt" action in either granting or denying a petition, with statement of reasons in case of denial.

(iii) Hearing Notice Procedure - Amendment Hearings

The recommendations as to the contents of hearing notices are as follows:

First, they should contain the name of the proponent of each proposition.

Second, they should contain a statement of each proposition.

Third, they should provide, as now, for evidence on appropriate modifications at the hearings.

(iv) Pre-Hearing Conference Procedure - Amendment Hearings

A pre-hearing conference should be held in the marketing area upon request of interested parties. Such conference should be presided over by the market administrator or regional field man (the application of the word "regional" to the designation "field man" will be explained hereinafter). Such conference should be for the purpose of discussing the issues. This conference should not be held if doing so will delay the hearing.

(v) Hearing Procedure - Amendment Hearings

Hearing officers should be careful about not interpreting too broadly the "appropriate modification" provision of the hearing notice. Agency personnel should refrain from issuing amendments having no hearing record basis.

(vi) Post-Hearing Procedure

After the Recommended Decision is published, but before the time for submission of Exceptions, a conference should be called in the marketing area upon notice to and with participation limited to those parties who have participated in the hearing, presided over by a hearing officer, market administrator or regional field man as provided for in the pre-hearing conference, at which post-hearing conference there should be a complete discussion of the Recommended Decision to assist interested parties in preparing Exceptions, etc. This will necessitate amendment of the "cloture" rule so that it will apply only up to issuance of recommended decision.

(b) Order provisions as related to speed and effectiveness

The Committee feels that study should be given to the advantages and disadvantages of order provisions for the Secretary to have the right to change prices within fixed limits upon recommendations of an order-created industry committee acting in areas and under standards prescribed in the order. Some members felt that, without expediting pricing changes by this method they could not go along on many proposed refinements and improvements on petition, hearing notice, pre-hearing and hearing procedure, in addition to those above proposed. Such additional suggestions included, among many other things, formal rules for written evidence. These additional improvements, while saving time and having other advantages in the actual conduct of the hearings in the opinion



of some members, would take more total time between petition and the effectuation of amendments. Some members felt that the quicker changes on committee recommendation would be needed as a condition or offset to the slowing up of action through the further improvements and refinements in amendment hearing procedure that were discussed. Therefore, since the committee as a whole was against recommending anything except study on the proposition of "flexible pricing" on industry committee recommendation, some members wanted no action taken on the further procedural improvements and refinements proposed in discussions and a sub-committee report. However, there was some interest in the "written evidence" proposal, which is a subject that has been studied for some years by industry groups.

(c) Regional Field Men

The Committee strongly recommends the stationing of field men in various regions for the purpose of greater co-ordination of orders in such regions, both as to provisions and administration, through the acquisition of better knowledge of local market conditions and problems; also for the promotion of better public relations. This is particularly important in regions more distant from Washington or where adjacent orders require coordination. Better personnel development and maintenance policies and methods are necessary to implement this recommendation.

II. Referendum Procedure

The Committee's position is as follows:

(a) Continue to package amendments on basis of one vote on all.

Some members disagreed with this and think unrelated amendments should be submitted for a separate vote.

(b) Continue the requirement of favorable votes on amendments by findings that the order will no longer tend to effectuate the declared policy of the Act unless such amendment be approved. Some members disagreed with this. Where producer sentiment is important an advisory referendum might be conducted for the purpose of determining such sentiment before final decision.

(c) Have a local outside agency, such as certified public accountant licensed by the state in which the principal production area for the market is located, supervise any referendum that may be held for the purpose of ascertaining producer approval of the original promulgation of any order, including in such supervision the correctness of co-operatives' claims to vote on behalf of producers and the number thereof.

(d) Announce the result of the referendum in the greatest detail that can be furnished without disclosing individual producer's or cooperative's votes, as now being done.

(e) Whenever a referendum is used for determining producer approval, use as a "representative period" a current month.

(f) Publish policy for determining "representative periods" and cooperative affiliation.

III. Review Proceedings under Section 608c(15)(A) of the  
Agricultural Marketing Agreement Act.

(a) Time Limit

The Committee recommends that the General Regulations with regard to (15)(A) proceedings be amended to provide that if, after the expiration of

some specified number of days from the time when the hearing before the hearing officer, including briefing and oral argument, is concluded, the hearing officer has not ruled upon the matter or that if, after the expiration of a specified number of days from the time when the record, including briefs and oral argument is complete, the judicial officer has not ruled upon the matter, then it shall be considered that there has been a ruling adverse to petitioner. This is for the purpose of giving the petitioner the right immediately to pursue his (15)(B) remedy.

It is the thought of the Committee that in any (15)(A) proceeding where the decision of the Secretary or judicial officer or even the hearing officer is being held up awaiting a court decision on another proceeding on the same facts which may be decisive of the petitioner's proceeding, or where some other situation arises warranting further delay, no trouble should be experienced by the Department in obtaining extensions of time from the petitioner.

(b) Hearing Officers

They should be permanently assigned to the Department and be familiar with milk regulatory work, if possible. They should be more strict in excluding palpably irrelevant evidence and stopping unduly repetitious cross-examination, as provided in the Administrative Procedure Act and the General Regulations and as urged by the President's Conference on Administrative Procedure.



#### IV. Miscellaneous

##### (a) Management of Market Administrators' Offices and General Effectiveness of Departmental Personnel Connected with Order Programs.

The only recommendation that the Committee has to make after carefully considering the above item is that the Dairy Division should authorize market administrators to call meetings of handlers and producers' cooperative associations subject thereto for the purpose of having such persons appoint in each order market a small committee from their managerial personnel to review with the respective market administrator top management problems in the operations of the market administrator's offices and to meet with the market administrator from time to time for such purpose either on the request of the committee or of the market administrators. It is the opinion of the Committee and they so recommend that in markets which have no provisions in their orders for the establishment of classification and auditing provisions by regular industry consultive procedure, such as that in the New York order, there be established in addition to the handlers' top management review committee, a handlers' accounting and auditing committee composed of experienced personnel in such lines to meet with market administrators' personnel to consider accounting and auditing problems.

##### (b) Order Provisions for Pool Payments for Market Service.

###### (i) To Co-operative Associations

The Committee recommends that no legislation be sought at this time to expressly authorize such payments to cooperative associations. There is a court case pending on the question of whether such payments are legal under the present law. If the decision is adverse to the legality of such payments,

or if the milk sections of the Agricultural Marketing Agreement Act are definitely and seriously opened up for amendment, some members of the Committee feel that the Act should be amended to authorize payments from pools to cooperative associations of producers for market-wide services performed by them of benefit to all producers, except those services which are also performed by proprietary handlers. On the other hand, there is some feeling in the Committee that such a statutory amendment and resultant order provisions for such payments would be so controversial not only between cooperative and proprietary interests, but also between diverse cooperative interests that initiation and administration would be impracticable.

(ii) To handlers

If the existing litigation results in a broad construction of the "incidental" provision [Sec. 8c(7)(D)] of the Act, orders in appropriate instances might provide for pool payments to both co-operative and proprietary handlers for market stabilization in the handling of milk to the extent that such services are performed.

If the court decision is adverse to the legality of such a broad construction of the "incidental" provision of the Act and if the milk sections of the Act are definitely and seriously opened up for amendment, then some members of the Committee feel that an amendment should be sought to legalize such payments.

(c) Retrospectivity

There is considerable criticism in the industry of reversals by market administrators of rulings previously made by them with resultant audit charges. This subject is being treated by the American Bar Association as an

"all industry" legislative problem. However, the Solicitor might be able to figure out some way to set up a rule or regulation similar to that established by proposed legislation (known as the "good faith reliance" bill), so as to bring about the relief provided by the bill and the resultant answer to industry complaints, without awaiting for the bill to be enacted into law.







